Outlines of Economics.

1830

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for a few weeks subject to much the same kind of run as London and Berlin had experienced

France also did not go unscathed in the panic After the depreciation of the pound sterling, a number of banks were forced to close down"—*World Economic Survey*, 1931-32, pp 61-82

Things which are not causes of the World Economic Depression.

Why is the world economically depressed? *The causes of the world economic depression are not to be found in*

(1) *Insufficient human demand for goods* and man's inability to consume such goods

Even in the richest countries there are several million persons who have wants unsatisfied, who want more of comforts and luxuries and many millions in want even of bare necessaries The case in poorer countries can well be imagined The fact is that in this world though there is unlimited demand, very many millions have not enough purchasing power to purchase commodities to satisfy all their wants relating to necessaries and reasonable comforts (not to speak of luxuries)

(2) *Insufficient power of Nature and of science to supply goods for the satisfaction of human wants*

The increasing application of science by man to production in agriculture, manufacturing, mining and transport industries, etc , and the increasing application of machinery have made possible a vast increase in the production of crops, manufactures, minerals, transport services

The world is starving in the midst of plenty *It is a crisis of plenty and not of scarcity* Plentiful supplies of agricultural and manufactured commodities can be produced cheaply and efficiently under modern conditions They are not plenti fully produced because they cannot be sold Many comm
are plentifully produced do not get sufficient sale
t reason is that the buyers—the large majority
ry country—have not sufficient purchasing pow

of the World Economic Depression. Re

rtain different theories about the ca
depression

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Some writers favour overproduction theories Some favour underconsumption theories

Sir Arthur Salter in his *Recovery*, 1933 deals with many causes and remedies in connection with the World Economic Depression

Einzig in *The World Economic Crisis*, Chap III thus enumerates the principal theories which have been put forward to explain the present crisis

"(1) Periodic crises (business cycles)
(2) The necessity of return to the pre-war level
(3) Over-production
(4) Under-consumption
(5) Monetary causes
(6) Over-speculation
(7) The moral factor
(8) Coincidence of a number of independent factors

Cassel and some other economists emphasise much the monetary cause—the *maldistribution* of gold by which the United States and France have got more than half the world's gold and *the other countries less than their due share and thus have falling prices which have extended also to the United States* (because of the *sterilization* of gold there, preventing expansion of credit based upon their additional gold supplies)

Competent economists generally point to a combination of causes bringing about the world economic depression

Different causes.

(1) According to Sir W H Beveridge and Dr Gregory *the fall of prices must primarily be regarded as the reaction and the inevitable sequel of a previous period of inflation*—"the reaction from the world boom of 1925—29, a boom which was itself prolonged by the failure to take earlier steps to correct it *Neither gold shortage, gold maldistribution, nor lack of Central Bank co-operation is sufficient to explain* the unsatisfactory character of the general economic situation"—Gregory, *The Gold Standard*, 1932, p 38 As Sir William Beveridge puts it "Though *the deflation of purchasing power and consequent fall of prices* may be described as *the cause*

of the crisis, the deflation itself is probably an inevitable sequel of a previous inflation Inflation and deflation cannot be divided They are inflation and *deflation of credit rather than of gold That is the crisis, as shortly as I can put it*"

"Let me sum up in a few sentences the essentials of the crisis It has come about through a fall of prices initiated from the side of money, a deflationary fall of prices That fall has produced unexampled paralysis—it has probably itself been made greater—because it has met with unexampled rigidities of the economic system"—*The World's Economic Crisis*, 1932, page 175

*** (B) War-Debts and Reparations and Maldistribution and Sterilisation of Gold.**

"The fundamental cause was the claim of reparations and war-debts, combined with the unwillingness of the receiving countries to receive payment in the natural form of goods and services"—Cassel's *Memorandum of Dissent*, in the *Report of the Gold Delegation of the Financial Committee*, Geneva 1932

When Germany was paying reparations to the allied countries, it could pay them by sending exports of goods or of gold, or by borrowing money from the United States or any other country for paying such reparations What the

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* "We must conclude, therefore, that the one-sided movement of gold into France and the United States during the period in question is the combined result of the insistence of these countries on war-debt payments and their unwillingness to receive these payments in the normal form of a surplus import of goods and services

The fact that the gold-receiving countries failed to use their increasing gold reserves for extending the effective supply of means of payment must be regarded as abnormal and, therefore, as an independent cause of the fall in prices at the side of the maldistribution of gold itself *The payment of war debts in conjunction with the unwillingness to receive payment in the normal form of goods led to unreasonable demands on the world's monetary gold stocks, and the claimants failed to use in a proper way the gold that they had accumulated* This statement may serve as a conclusion of our examination of *the essential causes* of the extraordinary fall in commodity prices since the middle of 1929 and of the following collapse of the Gold Standard system"—Cassel, *The Crisis in the World's Monetary System*, 1932, pages 71-72

allied countries got in reparations, they passed much of these reparations to the United States in connection with their war-debt payments The United States were unwilling to receive reparations and war-debt payments in goods France was unwilling to receive reparation payment from Germany in goods They had high tariffs upon imports of foreign goods So more than half the world's gold flowed to the United States and France in connection with these payments, and this maldistribution of gold helped to bring about fall in prices in other countries and the sterilisation of gold in the United States by banking policy prevented rise in prices there and an outflow of gold into the countries which needed larger supply of gold badly

It was maldistribution and sterilisation of gold, rather than actual shortage of the total world supply of gold, which helped to bring about this situation

Also Germany, after a time, could get no further loans from America to pay reparation payments

As already stated, the falling prices brought losses to producers, seriously reduced employment, production, world trade, increased the burden of debt of business men and of debtor-nations

Cessation of Foreign Lending.

The fall in the general level of commodity prices made people unwilling to invest savings in production The rise in the value of money increasing the burden of debt brought about widespread incapacity of debtors—private debtors, business men and others, also governments—to meet their obligations This led to general loss of confidence and brought about the cessation of foreign lending by the United States which materially aggravated the situation

Economic Nationalism.

The fall of commodity prices increased competition in the world market Every country, partly to protect its own depressed industries against the competition of cheap foreign imports and partly to reduce foreign claims on its currency and also in part to secure some revenue for the financially

embarrassed government, imposed restrictions on foreign trade, taxed heavily foreign imports This kind of economic nationalism restricting the advantages of international trade and international division of labour, impoverished each country and impoverished the world as a whole ' Such a situation went to increase the depression

Rigidities in the post-war economic system.

The post-war economic system has more rigidities than the economic system of the pre-war world In the post-war economic system we have not only the rigidities in connection with reparations and external war-debts, but also the rigidities of larger internal debts, of larger debenture interest payments, of wages more rigid now under the influence of determined trade union action, of supply of commodities more rigid under recent conditions of large-scale production and large-scale management

Various rigidities in the economic system serve to deepen the depression

Want of International Co-operation.

Want of sufficient international co-operation among the central banks and among the Governments of the world as regards credit, gold and financial policies, want of international co-operation, as regards production, and marketing of important food crops, raw materials, manufactures are playing their parts in connection with the aggravation of the depression

An immediate cause.

A cause immediately precipitating the depression was the speculative boom in America and the crash that followed in the autumn of 1929

Remedies.

The causes suggest to a certain extent the remedies They need not be enumerated in detail †Refer to the remarks of

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† "What are aggravating factors which account for the peculiar intensity of this depression?

I will first mention four which are independent of the war or war

Sir Arthur Salter in the footnote in this connection How far the remedies are practicable under present conditions is an entirely different question

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policy, and would in any case have caused trouble on a bigger scale than we used to know in the nineteenth century

I *Causes not due to War*

In the first place the large scale of the organization of modern businesses sometimes makes them less flexible to sudden changes in demand and in price

Next demand tends to be more capricious This is very largely because the world is now more prosperous, there is a very much bigger margin of purchasing power after the bare necessities of life have been paid for

In the third place, we are now between two different systems, each of which will work, but which in combination I will not say are impossible, but are difficult On the one hand there is the old competitive automatic adjustment of changing prices, to which we were accustomed before the war, the changing price adjusting supply to demand

On the other hand there is, as in Russia, the alternative system of deliberate planning

Fourthly, there is one other factor in this depression which is independent of the war, the mechanization of grain production I believe that if there had not been a general economic depression at all, and never an industrial depression, and never a war, we should still have had at about this period an agricultural depression The desire for industrial products is practically illimitable The human stomach, however, is not so elastic

II *Causes due to War*

So much for the reasons that are independent of the war I now come to a number which clearly arise out of the war period In the first place there are reparation and war debts First of all reparation is a dead weight charge It represents expenditure or waste in a past war It has no counterpart in an earning industrial asset In the second place, reparation is inevitably involved with political conditions and political dangers It therefore makes the basic political condition of the world unstable

Next we have the whole question of gold and gold prices I cannot go into this problem to-night I will only make this remark as to how it affects the depression When a country like America or France is owed money in respect of war debts, other past loans, or reparation, or exports, it can only be paid by taking goods as imports, or out of the proceeds of new loans, or by taking gold Imports have, however, been blocked by tariffs, lending has practically stopped because of the loss of confidence Gold has therefore flowed to these two countries from those which owed them money This gold was, however, not wanted as the basis of currency, and has not, in fact, been used as a basis of as large a volume of money and credit as in the countries from which it came This is what is meant by saying that there is a "*maldistribution*" of gold and that it has been "*sterilized*" The consequence has been that the effective money in the world has been reduced There is enough gold in the world to support a higher level

Economists differ, to an important extent, as to the causes of and remedies for the world economic depression Even if the economists were agreed as regards the remedies and their respective importance—they are far from agreed—the govern-

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of prices than the present one if it were properly distributed *Scarcity of gold was not, I think, the initiating cause of the fall of prices, but, rendered less effective by maldistribution, gold has tended to consolidate a fall due to other causes instead of exercising a correlative function*

Prices having fallen and remained low, there has been a heavy weight upon the whole enterprise and initiative of the world, because the obligations of the active part of the world to the inactive have been proportionately increased

Take for example, the agricultural producing countries The value of their products has fallen by about fifty per cent

The next cause I will mention is the reckless borrowing, particularly by Governments and public authorities, in the years just before the depression

Lastly, as a cause immediately precipitating the depression, there was the speculative boom in America and the crash that followed it in the autumn of 1929

When the depression had continued for nearly two years it was intensified by the financial crisis of June 1931

Various political incidents gave this shock in the early part of 1931 There was a run on the short-term advances It was soon evident that they could not be paid This constituted the financial crisis And it has in practically every respect deepened the depression

I now come to remedies

First, reparation and war debt, already suspended, must obviously be suspended for a longer period They must also be greatly reduced

Next, we need reform in monetary policy I should like to see gold prices brought back to the level at which they stood in 1929 before the depression began And after that I should like to see an approximate stability in the general price level If the first could be achieved, a new stimulus would be given to enterprise, and the burden of debt, both public and private, would be lightened If the second were possible, recovery, once attained, would have a much better chance of being permanent

I believe both are practicable if the world really desires them Gold prices could be raised if countries with a gold surplus would use their gold to create a bigger volume of credit and money In other words, if there were a limited inflation in America and France This would increase imports into these countries—and indeed would be useless if it were prevented from doing so by new tariffs To facilitate imports is not popular, of course, especially when home industries are depressed But now that lending has stopped, and debtor countries can no longer send substantial quantities of gold, the balance of trade of creditor countries must be changed This can only be done by an increase of imports or a loss of exports, or both In the extent to which imports are welcome, exports will be saved There are, of course, difficulties, both technical and political, but they are not insuperable, and America appears to be now contemplating action of this nature

ments of the world, as at present constituted, have not sufficient courageous statesmanship and the spirit of international co-operation to apply the proper remedies to a world suffering from the ills of the depression *The inherent strength of the capitalist system will pull it through this crisis and depression*

So, too, when a tolerable level of world prices has been regained, the level could afterwards be kept reasonably stable, if the world were agreed and determined Central banks in co-operation could, within certain limits, maintain short-term stability by their customary methods When a continuing scarcity or excess of gold was found too strong for them the gold content of currencies could be simultaneously and equally changed

One word as to the policy of countries now off the Gold Standard More than half the world is now in this category We are among those who have for the time abandoned gold We should make our main objective the substantial maintenance of the internal purchasing value of our national currencies This objective should, I think, dominate every sphere of policy, including that of tariffs, because internal purchasing value is the only anchor of real value once gold has been left, and if this anchor drags there is no saying how far our currency might depreciate If we can successfully maintain the purchasing value of the pound in this way, and to this extent, we should have a currency both useful to ourselves and respected by other countries Those who have followed us off gold might follow us in this policy They might look to us as a leader We could concert our policy together, establish stability of exchange with each other, and limit the fluctuations of our exchange with the gold countries

This would have great advantages First, it would mean that if it proves impossible to secure the conditions required to enable the Gold Standard to function reasonably well in future, we should at least have a tolerable alternative

But secondly, to be prepared if necessary to use a concerted managed currency gives a better chance of not being forced to rely upon it For it would give us—the countries now off gold—a much stronger bargaining position in the very difficult negotiations with the gold countries

Next, tariff and commercial policies must be reformed Neither world trade nor a world monetary policy is compatible with nationalistic economic policy

Next, we need to try to restore foreign lending as soon as possible This will be difficult It means the re-establishment of confidence very badly shaken

Lastly, as the indispensable foundation of any tolerable world economic structure, we need assured peace in the world

But let me remind you, in conclusion, that the problems before us, difficult as they are, are essentially capable of human solution If either Nature or Science were failing us we might have no alternative but to endure But our difficulties come only from defects in human organization And what man has made, man can reform

We need better organization and regulative wisdom, magnanimity in policy and courage in action For world problems it is not enough to

—*this is the opinion of Mr J M Keynes and Sir William Beveridge,* as stated in *The World's Economic Crisis,* Halley Stewart Lecture, 1931

think nationally, or even imperially, we must think internationally" —Sir Arthur Salter, Halley Stewart Lecture 1931, *The World's Economic Crisis*, pp 24-39

In another lecture contributed to the same series, *Sir W H Beveridge differs from Sir Arthur Salter as regards the possibility of the problems of the world economic crisis being actually solved by deliberate human efforts,* national and international

"The fall of prices which has overtaken the world in the last three years is both more violent than any known before and has met with unexampled rigidities in our economic structure There are for some countries, not all, the rigidities of internal debts, for some, not all, countries because some have practically cancelled their internal war debts by inflation and depreciation There are for most countries the external debts, some arising before the war, some arising out of the war as reparations and war debts There is an increased rigidity of debenture interest There is a new rigidity of wages, fostered in some countries by an unwise insurance system In the special circumstances of the post-war world, any deflationary fall of prices would be more disturbing than a fall in times before the war, when the economic system was more fluctuating, when there were fewer rigidities of debts, wages, debenture interest, and the like

Let me sum up in a few sentences *the essentials of the crisis It has come about through a fall of prices initiated from the side of money, a deflationary fall of prices That fall has produced unexampled paralysis —it has probably itself been made greater—because it has met with unexampled rigidities of the economic system the deflation itself is probably an inevitable sequel of a previous inflation* Inflation and deflation cannot be divided They are inflation and *deflation of credit rather than of gold That is the crisis, as shortly as I can put it*

The crisis of to-day represents a failure to manage credit, to avoid alternate inflation and deflation of purchasing power The making of purchasing power is a privilege too important to be allowed to a subject

But gold is not our money to-day Nearly all our transactions are done by credit, and credit is made and unmade daily by thousands of private citizens, by bankers for business men and by sellers for customers Such machinery as we have for controlling that—through the operation of central banks—is not sufficient for its purpose The making and unmaking of purchasing power has fallen into an anarchy, and from the anarchy spring the alternate inflation and deflation which make our booms and depressions

The nations must seek to suppress the anarchy of purchasing power, *as they have suppressed piracy and slave trade,* as they ought to suppress war

Let the aim be clear It is only the anarchy of purchasing power that should be suppressed, not what some people call the anarchy of production

Let us hope that they will prove wise prophets in their generation

World Economic Survey, 1932-1933 (published by the League of Nations) notices signs of recovery from the World

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So I, for my part, come back to seeking a way out of the world's crisis within the framework of the capitalistic system, by suppressing, through international co-operation, the anarchy of purchasing power—by suppressing the anarchy of purchasing power and keeping and increasing the liberty of production and exchange That is the way of escape

If you ask me to translate those phrases practically, into things that could be done here and now, I encounter difficulties of two kinds—a technical difficulty with the economists, and a political difficulty with the Governments of the world

The technical difficulty is that though most economists, I believe, would agree as to the need for suppressing the anarchy of purchasing power, as I have phrased it—of stabilizing credit, as others might phrase it—they are not agreed as to just how this difficult operation should be carried out as to change of banking powers and policy involved, as to the principles on which an international central bank for all the world would control credit, if such a bank were established with full powers The credit cycle of alternate inflation and deflation is like cancer, we know a great deal about it, but not enough yet to be certain of a cure There is here a technical problem of economics still unsolved But if all the economists to-day were agreed upon the remedy for crises, what good would that do? Would the Governments of the world apply the remedy?

Just look at the Governments! Can any one think them ready for a great adventurous scheme of international co-operation in finance?

The world will not really escape this crisis at all Even if all the economists were completely agreed on a remedy, the Governments would not apply it *The world will not escape this crisis, not if escape means getting out of danger by deliberate thought and action* The world is like a patient with a disease for which the doctors have as yet no cure, except time and trust in his vitality, in the toughness of his system *I believe myself with Mr Keynes, that the toughness of the (capitalist) system will pull us through, that the crisis will become less acute of itself long before we have done anything to better it* The most that we can hope for this year—really it is too much to hope for this year—is that the Governments will do something, not to cure the crisis, but to remove some of its aggravations—will deal with reparations and war debts, with some of the obstacles to trade, with one or two needless rigidities We must plan to avoid another crisis later We shall not by conscious efforts escape this one"—Sir W H Beveridge, *Halley Stewart Lecture* 1931, *The World's Economic Crisis,* pp 174-187

Dr Gregory in *The Gold Standard and its Future* agrees with Sir William Beveridge that the fall of prices must be regarded as a reaction from a previous period of inflation

"To sum up, the post-War world is in some important respects markedly different from the pre-War world, notably in the degree to

Economic Depression "The statistical evidence of rising prices, increased production and diminished unemployment indicate that, in the second quarter of 1933, there was, at least temporarily, a definite upward turn in the business cycle The lowest point of the business cycle appeared to be past Production had increased, prices were rising, in many countries unemployment was falling and investment was being resumed

At the end of July 1933, there was more confidence and greater economic activity in the world as a whole than at any time since the financial panic began in the spring of 1931 The recovery in economic activity, however, varied greatly from country to country" (pages 302, 319, 327)

So far as present indications go, the world economic depression is not going to be remedied by immediate and deliberate international co-operation even among the leading capitalist countries and governments The failure of the World Economic Conference, 1933, points unmistakably to this melancholy conclusion

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which political influences exert a deterrent effect on the developments of economic life and in the extent to which the greater rigidity and inelasticity of the economic structure impose obstacles to the adjustment of relative incomes and prices The working of the gold standard as an instrument of enforcing international equilibrium, has suffered from these as from other elements in the present world situation notably the insufficient degree to which the normal relations between the long-term and the short-term money markets have been restored *Neither gold shortage, gold maldistribution, nor lack of Central Bank- co-operation is sufficient to explain the unsatisfactory character of the general economic situation the reaction from the world boom of* 1925-9, a boom which was itself prolonged by the failure to take earlier steps to correct it The appearance of certain new banking devices has probably on balance assisted to prevent speedy adjustment of the international situation Economy in the case of gold, though assisted by the development of gold exchange mechanism, has been impeded, not only by the nature of the reserve legislation adopted since the War, which requires the Banks in fact to hold reserves substantially above the legal minima, but also by the existence of an abnormally large International Short-Loan Fund This Fund is capable by its sudden movement of very rapidly depleting a reserve and of thus adding a new element of uncertainty to an already complicated situation —T E Gregory, *The Gold Standard*, 1932, pp 38-39

Questions from the Calcutta University B. A. Examination Papers (1909-1933).

BOOK I.

Introduction.

1 "When we grant to any branch of human knowledge the name of science, our object is not the simple bestowal of an honorary title We mean the facts with which it deals are connected by certain necessary relations which have been discovered and which are called Laws" State whether you consider that Economics can be called a science according to the above definition and give reasons for your answer (C U 1914)

2 What is meant by an Economic Law? Are we justified in saying that Economic Laws are analogous to the Laws of Nature? (C U 1910)

"The laws of Economics are to be compared with the laws of tides rather than with the simple and exact law of gravitation" Examine (C U 1926)

3 Discuss the position of Economics among the Social Sciences (C U 1910)

What is the subject matter of Economics? Explain in what way it is a social science, and bring out in your answer its relation to other social sciences (C U 1917)

4 (a) Discuss the relative advantages and drawbacks of (1) the Deductive Method, (2) the Inductive Method What do you consider to be the proper method of investigation in the Social Sciences? (C U 1911)

(b) What are the pre-requisites for the free circulation of labour and capital in a country? (C U 1910)

5 Give a brief account of the Mercantile Doctrine (C U 1923)

6 Describe the main features of present day economic societies (C U 1913)

7 Discuss the merits and defects of competition as a factor in modern industry (C U 1923)

"Competition is neither wholly bad nor wholly good" Amplify (C U 1926)

8 Trace the successive stages of industrial evolution (C U 1909)

9 Critically attempt a full definition of wealth How would you estimate a nation's wealth? (C U 1913)

10 Define Wealth, National Wealth, Capital, and in the light of your definitions examine the character of the following (1) natural facilities of transport such as navigable rivers, (2) natural intelligence or honesty of the labourer, (3) trained skill of an artisan, (4) services of

II. Economies of competitive power.

These are economies which a large business enjoys in competing with smaller businesses, and they enable the large business to beat its smaller rivals Economies of competitive power benefit only the big and powerful competitor, economies of productive power benefit the competitor and also society by increasing its efficiency of production

(*a*) A big firm is often able to take away the trade of smaller competitors by more *extensive and at the same time economical advertising and canvassing*, and this it is able to do with comparatively less expenditure in proportion to its business For its many goods advertise one another, it also secures cheaper advertisement rates and it has to employ fewer travellers and agents than it would be the case if its volume of business had to be done by several rival firms

(*b*) A large firm has many *other competitive advantages*—for with its larger resources it is in a stronger position *to keep down wages and to exact higher prices from consumers* (This is an advantage to the employer, but this abuse of power by the large firm is a great evil to the labourer and also to the consumer) Another source of competitive power lies in its ampler credit facilities

* Limits to Large-scale Production.

We may put it thus A firm tends to grow large because of certain economies attaching to large-scale production—

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* The final limits to the growth of a firm are thus given by Prof. Chapman —

(1) The internal complexity of arrangement
(2) The importance of quality in the output
(3) The expensiveness of the machinery used
(4) External relations depending on the nature of the markets touched

(5) Stability in the demand for the output.
(6) The stationary character of the industry in relation to methods or otherwise

(7) The extent of the economies to be secured by producing on a large scale (Prof Chapman—*The Lancashire Cotton Industry*, Page 169, quoted by Mr Hobson)

economy of labour, economy of machinery, economy of materials, etc , and certain economies of competitive power

There is, however, a limit to large-scale production resulting from the limit to these economies With the growth in the size of the firm, the limits to the economy of labour and the economy of machinery are soon reached The other economies of buying and selling, of advertising, etc , may still continue for some time but after a certain stage they are also exhausted

The ultimate limits to large-scale production are to be found chiefly in

(I) *The capacity and energy of the employer*

Sooner or later with the growth of a business, the business becomes too large for the capacity of the employer The difficulty of management puts a stop to the expansion of the business

(II) *The nature of the market*

The extent to which a firm can grow depends on the extent of the market and the character of the demand in the market Other things being equal, the larger the market and the more stable the demand the greater will be the tendency towards large-scale production

On account of these limits on large-scale production, there is in every industry a 'typical magnitude', a particular size of business which for the time being secures the maximum net economy This is the point of maximum efficiency A firm larger or smaller than this is less efficient as a business unit

In any country, in any given condition of industrial development there is for each industry a size of business where the maximum net economy is reached and beyond which, unless supported by a legal or natural basis of monopoly, it cannot grow

Conclusion about Large-scale Production.

Large-scale production (chiefly because of the economies and advantages it offers to the capitalist employers) has a strong tendency to increase in railways, shipping, many manufactures,

etc , at the expense of small-scale production , and this tendency of large-scale production to increase is considered by some people as the natural* 'survival of the fittest' and hence beneficial to the world—but this argument is not always strong and valid, *e g* lions and tigers survive in nature not because they benefit the world but because they are able to take good care of themselves

Large-scale production is beneficial to the world when through its superior efficiency *it secures substantial benefits to the consumers in the form of lower prices and for the labourers in the form of higher wages,* in addition to any profit it may secure for the employers , and *if large-scale production* (specially in the form of monopoly) *secures only huge profits for the employers while keeping up prices high for the consumers and keeping wages low for the labourers, then it is not of benefit to the world*

So large-scale production has its darker side

The economies of competitive power strengthen one business often unfairly at the expense of other businesses engaged in the same industry

If the movement towards large scale and concentration of industry were to continue indefinitely, then all small producers and small shop-keepers, etc , would disappear,—they would all become mere wage-earning employees of large-scale establishments directed by millionaire capitalists or by limited liability companies

Individual enterprise, with its freedom, its elasticity, its potentialities for individual and social progress would be a thing of the past Nothing would be left but one dead level of wage-slavery

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* As Prof Marshall says "Darwin's law of the survival of the fittest is often misunderstood . . *A race of wolves that has well-organized plans for hunting in packs is likely to survive and spread because these plans enable it to catch its prey, not because they confer a benefit on the world*" (*National Industry and Trade, Book I, chapter* IX)

And recent students and critics of the theory of evolution point out that not merely 'struggle' but also mutual aid and co-operation play a great part in the evolution of animals, men and society

Small-scale Production and the Small-scale Producer.

We have to distinguish between (*a*) healthy forms of small-scale production, and (*b*) unhealthy small sweated businesses worked by inefficient labour at low wages and under degraded conditions of life These sweated industries deserve no mercy, and they should get none They are foul blots on civilization , and should be quickly reformed or removed to make room for better things

But even in Europe and America, healthy forms of small-scale production survive in agriculture, in some manufacturing industries and in certain forms of retail trade In India with her old industrial organization, small-scale production naturally covers a much larger area than in Europe and America

Causes and conditions of Small-scale Production.

(*a*) We have production on a small-scale in industries where the economy of skill, the economy of machinery and other economies of large-scale production are absent or are comparatively unimportant—as in agriculture in many parts of the world

(*b*) Or where there are forces to counteract the tendency to large-scale production and to favour the small business—as in certain industries where great care, judgment and skill are required in the handling of expensive materials (*e g* goldsmith's work, jewellery work) or in the processes, and so these businesses cannot be carried on under the routine methods of large-scale production

(*c*) Again the independent spirit of the artist or craftsman may lead him to prefer to be an independent small producer with moderate profits than to be the highly paid employee of a big concern—this is often the case in India as elsewhere

Production is necessarily on a small scale when the market is a small one

Advantages of the Small-scale Producer.

The advantages of the small-scale producer chiefly relate to the *economy of the master's eye* , and there are also some

tendencies in modern machinery, methods of business organization and trade knowledge which materially help him

I *The economy of the master's eye*

(1) The head of a small establishment can exercise much more effective supervision over his business than the head of a large establishment *In a small business, the master's eyes are everywhere* He can personally see to it that his foremen and workmen are doing their work properly Strict personal supervision enables him to dispense with much of the book-keeping and a good deal of the complicated system of checks and in this way he saves considerably, especially in those industries which use expensive materials

Economy resulting from personal supervision

II We have to notice also some important modern tendencies which substantially reduce the disadvantages of small-scale production

(a) *Tendencies in machine development*

Some tendencies in modern mechanical development are helping the small business For example, the development of efficient small machines and arrangements for the cheap distribution of power (electrical and otherwise) are benefiting the small producer and may give him additional strength in future

(b) *The co-operative spirit*

The gradual strengthening of the co-operative spirit is enabling the small-scale producers by co-operation among themselves to secure some of the economies of large-scale production relating to (i) purchase of raw materials, tools and expensive machinery, (ii) sale of products and utilisation of by-products and (iii) use of credit

These modern tendencies in machine development leading to the making of cheap, efficient machines specially suited to the small producer, and also the growth of co-operative spirit and organisation—these are helping greatly the small producer in Germany, Ireland, Italy, they have arrested the decay of many small industries and have created new hopes and new prospects for them in future

(c) *Increasing diffusion of trade knowledge*

Technical knowledge and business secrets are now much less of a monopoly of the large producer

The small producer benefits and is benefiting in an increasing measure by the modern diffusion of trade knowledge as regards experiments and improvements in machinery, in business methods and organisation and also as regards markets This is brought about chiefly by newspapers, and trade and technical journals and they are available for a moderate price even for the small business man Again developments of scientific principles which furnish the ground-work for great industrial improvements are made by men of science These men of science often with great unselfishness make these things the common property of all, the large as well as the small producer , they do the thing not for money but for knowledge and the advancement of science

It is clear from the above, that the modern small producer, though he can seldom be in the very first line of industrial progress, yet if he has ability, energy and tact he will be able to attain a considerable measure of success in many industries , and in some industries small-scale production is the only suitable form

The small-scale producer is often an individual working with hired labourers , and the small-scale producer in Germany, France and Italy is in many cases a body of labourers working for themselves and such a body of labourers also will be helped very substantially by the economy of the master's eye (the labourers being in this case their own masters) and the tendencies of modern machine development (already referred to) and the growth of the co-operative spirit—*and this particular kind of small-scale production by improving the economic and social condition of the labourers will be very valuable in securing industrial peace, social stability and welfare*

So in the modern industrial organization small-scale industries have their place as well as large industries , and this we find in England, France, Germany and the United States and also in India Indeed in India the position of small-scale indus-

tries is one of very great importance for India (though it possesses a few large-scale industries) is still mainly a country of small industries

* SMALL-SCALE PRODUCTION IN INDIA.

(A) Present position of small-scale production in India. Vitality of many of these small-scale industries in spite of serious neglect by the Government and the people.

Indeed in India the position of small-scale industries is one of peculiar and extraordinary importance for *India (though it possesses a few large-scale industries* like the Iron and Steel Industry, Cotton and Jute Mills, Tanneries and leather factories, coal mining, etc) *is still mainly a country of small-scale industries of the older type*—these small-scale industries including (*a*) *small workshops* (*or karkhanas*) of small producers (each small producer employing a few workmen who use tools and not much machinery), engaged in weaving, metal industries etc , in towns and in villages and (b) *also cottage industries of the village* in which the worker works with the help of his wife and children in his own cottage in the village (these cottage industries include almost all the industries of the village and including the village weaver, the village blacksmith, the potter, the oilman, etc)

Indian agriculture is also a small-scale industry, the average Indian farmer with his small farm produces on a much smaller scale than the average farmer in Britain or in America

India lives in the village , *about 90 p c of the Indian population live in the villages* (as compared with about 55 p c in Germany and about 22 p c only in England and Wales) *and village cottage industries and village agriculture still supply most of the wants of the vast Indian village population* The village cottage industries still employ a very large number of men, a very much larger number than those engaged in the large-scale industries of the towns and in the mines, railways,

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* The student may refer in this connection to the *Imperial Gazetteer* (Vol III), the *Report of the Indian Industrial Commission* and also to *"The Foundations of Indian Economics"* by Prof R K Mukerjee

etc , and in addition to these village cottage industries, we have also the small producers in the towns and villages who own workshops and employ hired labour

The Report of the Indian Industrial Commission and the judgment of all competent observers make it clear that *many of these Indian cottage and other small-scale industries have still remarkable vitality* in some cases (e g weaving) even after struggling for decades against the formidable competition of machine-made goods made in India or imported from Europe , and with reasonable efforts made on their behalf, these Indian small-scale industries will be of immense use in promoting the economic and social welfare of the Indian people

We also find in Indian towns some development of small-scale industries of the modern European type employing modern machinery (driven by electricity, steam, etc) in small factories and employing a comparatively small number of labourers—these are engaged in flour-milling, paddy-husking, oil-pressing, etc*

(B) Economic, artistic and social value of Indian small-scale Industries—arguments for their preservation and development (wherever economic and other conditions are suitable and favourable)

Indian economists and the Indian people will do well to devote great attention to the question of the preservation and the improvement of these small-scale industries including cottage-industries (so far as present economic and social conditions will permit) partly because of

(1) *strong economic reasons—(a) the vast majority of industrial workers in India are maintained by these small-scale*

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* Small-scale production of this type occupies an important place in the national economic life of Britain, France and Germany and employs almost ⅓ of the total industrial workers For moral and social reasons, it is desirable that these small-scale businesses should in increasing numbers become workers' societies owned and worked by workers for themselves and not for a master, but as yet this is not the case, partly because the workers do not yet control sufficient capital and largely because the workers as a class have not yet developed the required amount of business ability for the work of management

industries (out of a total of about 55 million industrial workers, only about 2½ million persons work in large-scale factories, mines and railways and almost the whole of the remainder being maintained by these small-scale industries, and *any sudden abandonment of these old-established small-scale industries will mean great and undeserved sufferings* (in many cases starvation) *for the millions of skilled men engaged in these occupations* and *will drive millions of these workers into the ranks of unskilled labour or into agriculture already subject to diminishing return and the horrors of famine* (b) Also modern large-scale production in India in factories, mines, railways, etc, employs only about 2½ million persons, and *with the present insufficient supply of capital, technical skill and organization in India, it will be absolutely impossible to develop large-scale production so largely as to provide employment for the many millions who will be thrown out of work by the sudden collapse of these small industries* This further strengthens the economic case for the preservation and the improvement of the small industries

(ii) partly because of the *high artistic value of many of these small industries* Enthusiastic appreciation of these Indian art industries is to be found not only among serious students of Indian art but in cultured circles all over the world —and Marshall, the great English economist and champion of modern large-scale methods, in his book *National Industry and Trade* refers to India as the 'originator of many of the subtlest and most artistic manual industries' and to 'the supreme lessons of Indian art'

The destruction of these artistic industries will spell the loss of the rich artistic inheritance of ages, it will be an irreparable loss to India and Indian culture and indeed to the world This must be prevented

(iii) *partly because of the moral and social value of work done in the cottage industry by the worker for himself* (and not for any master) securing his self-respect, his economic and artistic freedom, social and industrial stability, *and the worker works in his own village home* surrounded by his wife and children and under the watchful eyes of the village elders and away from the drink and other temptations of the wretched,

insanitary slums of modern Indian industrial towns like Calcutta and Bombay

The destruction of these old-established small-scale industries like the village weaving industry and other industries (by the competition of foreign manufactures like imported piece-goods, kerosene oil, glass-ware, enamelled ware, etc , and also in some cases by the competition of the domestic large-scale industries like Indian Cotton Mills, etc) *with their tragic results has already taken place to a serious extent, and the greatest efforts should now be made to stop further destruction (wherever economic and social conditions permit)* , and as regards those particular small-scale industries which cannot be saved, a sufficient period of *transition* should be secured to them to lessen distress and suffering to the workers

The decay and destruction of many of these small-scale industries (including cottage industries) is due largely to lack of capital and lack of organization in general (including extremely imperfect marketing organization) , and the situation is made graver still by the culpable neglect of the Government and the leaders of the people *The remarkable vitality exhibited by many of these small-scale industries indicates that with substantial help from the Government and with organized popular support and strong Swadeshi sentiment in favour of them, there is a great future for some of them and hopes for many*

The people must do their duty and also they must make the Government do its duty

(C) Industries suitable for the small-scale organization and cottage industries.

The small-scale industries which have the best chances to survive and to develop are those industries—

in which the demand for the product is limited to particular individuals and classes or areas making it difficult for the large-scale producer to compete, e g

(a) *artistic handicrafts and decorative industries* (e g shawl and carpet weaving, the finer kinds of cotton-weaving, metal-work, ivory-work, wood-carving, etc) which produce ex-

pensive goods for the rich and in which the large-scale producer finds it impossible to compete because of the limited market and the artistic quality of the products

(b) *industries depending upon the individual character of the demand* where the individual consumer refuses to accept the common machine-made commodity and has his own individual taste to be satisfied, *e g*, the making of the better kinds of furniture, boots and shoes, tailoring, book-binding Here the handicrafts have a great advantage over large-scale machinery production (in factories) in India and also even in Europe and America

(c) in industries which are not artistic and do not satisfy individualised taste and *which produce only coarse work* (e g the coarsest cloth like some varieties of *khaddar*) *with coarse materials* when the demand for particular patterns, etc , is too narrow and local and then the large-scale factory cannot profitably compete

If the product of the handicraft small industry is more *durable,* (like the *khaddar* produced in certain parts of India) than the product of the large-scale factory, that is an additional point in its fvour

Often in industries referred to under (*a*), (*b*) and always in the ordinary village cottage industries, the small producer is helped to some extent by the proximity of his market and knowledge of local demand—and in most cases the worker works in his home and finds energetic support in the collaboration of the members of his family in his work and in the moral value of work done by him in his own home

A cottage industry (e g hand spinning or weaving) in some localities derives much economic strength from the fact that it employs the leisure hours of the agricultural population—specially in certain seasons of the year when there is little or no work in the field It utilises labour power which would otherwise be wasted , and so often it produces at a comparatively *cheap cost*

(D) How are the small industries to be helped?

These small industries of the old type for their preservation and development in the future will require Government

and popular support as regards (i) *technical education*, adapted to modern conditions without denationalisation and suited to the local requirements of the different localities where the different industries are situated, (ii) *financial help*, (iii) *satisfactory organization of the marketing of their products* In India, the people have as yet got only limited protection of domestic manufactures from foreign competition by means of 'scientific, discriminating' taxation of foreign imports, and so in view of the great economic, artistic, moral and social value of Indian small-scale industries and specially the cottage industries, *a strong Swadeshi sentiment among the Indian people in favour of the use of the products (not merely khaddar but also other products) of these small-scale industries will greatly help* the sale of these products and will prepare the way for the salvation of these small-scale industries (*Swadeshi* is voluntary protection and so is without some of the disadvantages of compulsory protection by law) Of course mere sentiment is not enough, but under the shelter of the protecting Swadeshi sentiment, earnest efforts must be made to improve efficiency of production by better technical education, better finance, better tools and implements and better methods of production and marketing Japan has magnificently developed large-scale production within the short space of half-a-century but Japan is equally successful in her small industries—and the success of small industries in Japan is due largely to efficient marketing organization, and also to adequate financial aid and technical education

As regards some small industries of the old type, and also most of the new Western type consisting of small workshops worked by electricity or other power and employing a small number of labourers (in some cases the labourers being their own masters and proprietors of the business), *modern tendencies in machine development leading to the invention of efficient, small machines help the small-scale business*, and the modern diffusion of trade knowledge also helps the small business,

and above all *co-operation*—co-operative banking supplying capital to the small industry at a reasonable rate of interest, co-operative purchase of raw materials, tools and machinery,

co-operative marketing, co-operative production—will do wonders in giving new life and prospects to small industries in India as elsewhere Co-operation is the one great hope of small industries (including cottage industries) all over the world , and the *necessity for co-operation is nowhere greater or more urgent than in India*

LARGE-SCALE AND SMALL-SCALE PRODUCTION IN AGRICULTURE.

The advantages of large-scale and small-scale farms compared.

1. The advantages of large farms.

Production on a large scale does not attain such dimensions in agriculture as in manufacture and the carrying trades (like railways and ocean transport)

Still there are large and small farms in every country And the average size of a farm in a particular country depends not only upon economic but partly also upon political and social conditions, legal institutions and historical antecedents In India the size of the average farm is much smaller than in England , and in England it is smaller than in the United States

The following advantages are claimed for large-scale farming as against small farms

(1) As regard the *land* itself, there are certain advantages that can be only obtained from a comparatively large surface, *e g* the proper rotation of crops, the due proportion of arable to pasture, good roads and a good drainage or irrigation system (as required by the circumstances of the case)

(2) With regard to the application of *capital,* large farms have advantages as regards buildings of all kinds, implements, machines, and in carriage to and from the market,—advantages which small farms can only partially obtain by co-operation

(3) With regard to *labour,* it is plain that the large farmers have greater command of scientific skill and are better able to adjust work according to the differences in the capacities of different labourers than the small farmers

(Prof Nicholson's verdict in favour of large-scale farming is due in some measure to the fact that in his opinion the British agricultural labourer under the large-scale farming system is generally better off than the French peasant proprietor under the small farm system)

(4) Large farmers are also more likely to utilise by-products, make experiments and adopt readily new agricultural inventions relating to machines and processes

Evidently *the large farm with its somewhat routine methods and general supervision is better adapted to the cultivation of staple crops, viz , wheat, cotton, etc , and the small farm with its more detailed and personal supervision is more suited to those flowers, fruits and special crops which require special skill and care on the part of the producer*

(A) Limitations to large-scale production in agriculture.

Large-scale production is not and cannot be carried to such lengths in agriculture as in many manufactures and in transport industries, etc , and this for the following reasons

I *The economy of skill* from thorough and extensive division of labour is not so much possible in agriculture as in some manufacturing and transporting industries

II *The economy of machinery* is also less Generally speaking, in agriculture machinery is much less specialized and also there is much less use of machinery than in manufactures, etc

III *The economy of management* Then we have the important question of the economy of management

(i) Agricultural operations as distinguished from manufacturing operations are necessarily spread over a considerable area of land

(ii) Agricultural operations being of many different kinds are not so easily reduced to fixed routine

These two circumstances make supervision difficult in agriculture The result is that agriculture has nowhere shown the tendency to large-scale production in the same degree as manufacture (in which there are special facilities for concentrating a great deal of work in a small area capable of close supervision)

(B) Special limitations in India favouring small-scale production as against large-scale production in agriculture.

These are some of the general limitations which exist in all countries, special limitations may also exist related to the conditions of a particular country The farms in some countries are smaller than in other countries They are smaller in India than in England The large English farm requires a large plot of land, large capital, suitable farm buildings and communications with markets, and a comparatively high degree of organizing ability on the part of the farmer In India, the small amount of agricultural capital in the hand of the average farmer, the minute sub-division of land by the law of inheritance and the low organizing capacity of the average Indian farmer because of his want of education, etc —they all limit the size of the average farm in India and make for small-scale production

Many Indian Zemindars have the land and some of them have the capital required for large-scale agriculture , but very few have got the experience and inclination for the work Educated Zemindars and educated men of means among the middle class might attempt with success large-scale production in agriculture , but the signs so far are not forthcoming in any appreciable degree

II. The advantages of the small farm.

(1) *Fruits, flowers and crops requiring special skill and care*

The small-scale farm has certain important advantages as regards agricultural products which require a great deal of attention, skill and care on the part of the farmer, *e g* , the finer and more costly fruits, flowers, plants and crops

In agriculture, the importance of labour is greater and the importance of the manager or entrepreneur is less than in manufacture , and therefore the stimulus given to the individual labourer by the sense of proprietorship is a far more potent factor in agriculture than in manufacture The small farmer

who is the proprietor of his small farm naturally works with more energy, care and thrift than the paid employees of the large farmer

(2) *Co-operation helps the small producer in agriculture*

Small farmers by forming co-operative associations may realize some of the economies and advantages of large-scale farming without sacrificing their independence, their initiative and the personal interest springing from the sense of proprietorship—and thus co-operation enables them to combine in part the advantages of large-scale farming as well as small-scale farming

Agricultural co-operation among small producers has produced very successful results in Germany, Denmark and also to some extent in Ireland Statistics show that even in the United States which used to be cited as a country devoted to large-scale farming, the number of farms has increased more than in proportion to the growth of population , so American agriculture shows no tendency to become a large-scale industry

The farm and the question about its proper size.

Will the agricultural classes and society as a whole gain generally or lose by increasing or diminishing the size of the average farm, and by less or more intensive farming?

As regards this question there cannot be any simple answer—the answer to this particular question at any particular time and in any particular country will depend upon a variety of circumstances, partly economic and partly social and political *Speaking generally, it may be maintained that in modern countries in the immediate future, a combination of large and small farms is desirable*

(a) Large farms commanding a large amount of capital are wanted to set a high standard of cultivation and to take a leading part in the improvement of agricultural methods Small farms have special advantages as regards agricultural products (costly fruits, flowers or crops) requiring a great deal of care and attention on the part of the proprietor of the farm, and even as regards other agricultural products, small farms by establishing co-operative associations will be able to combine in some measure the advantages of large-scale farming and small-scale farming

In India (a country of small farms) large-scale farms started by educated zemindars and educated men of the midle class (using their

own or borrowed capital) may play a great part in improving the standard of agriculture, and they are greatly wanted—but they are not forthcoming as yet in sufficient numbers

(b) The increase in the number of small farms in a country of large farms (like England) is also eminently desirable on grounds not always strictly economic but social and political in character In England, the Parliament has passed the Small Holdings Acts authorising county councils to purchase land and sell them in small holdings—the object being to prevent to some extent the drawing of the best part of the rural population, the energetic and ambitious young men, from healthy outdoor life in the village to the crowded manufacturing towns

Present position in large-scale production.

As has been already seen, the limitations to large-scale production spring from the difficulties of superintendence and partly from other causes

(1) The tendency to large-scale production is most powerful in *transport industries* In all advanced industrial nations railroads and steamship lines are controlled by big businesses, as in these kinds of work, large-scale production has very considerable advantages over production on a small scale

(2) *Mining* has become almost entirely a large-scale business The large and increasing use of machinery and other economies contribute to the growth of large-scale production in this industry

(3) In many *manufactures*, the tendency to concentration and large-scale production is powerful Manufacture has special facilities for employing machinery and for concentrating a very large amount of work within a small space capable of thorough and systematic supervision This tendency is particularly operative in the making of goods which constitute the necessaries and prime conveniences of life for the people

(4) In *wholesale commerce*, large-scale business is the rule, and so also in *banking and insurance*

In retail trade, the small shop-keeper through mere proximity and also through his personal relations with customers enjoys important advantages, and so he holds his ground. Even in retail trade, large establishments (like the great Depart-

ment Stores of the U S A , like Whiteley's in England and on a somewhat smaller scale Whiteaway and Laidlaw in Calcutta) have been, to a certain extent, displacing small establishments because the large establishment has a larger and more varied stock and it offers other conveniences to customers while it secures economies as regards its buying and cost of transport

(5) In *agriculture,* the progress of large-scale production is very inconsiderable owing to difficulties of superintendence and other disadvantages

Large-scale production is most successful in transport and in some manufactures and least so in agriculture

The movement towards large-scale production is at present very strong in the industrially progressive countries of the world This movement towards large-scale production is also noticeable in India but it is not so powerful as in England or Germany or the United States for the industrial revolution is not yet greatly advanced in India An immense expansion of production on a large-scale in the United States, in England and in Germany is the result of this tendency , and the Trusts, Kartels and other combinations under which production on a gigantic scale is carried on will be discussed in the next chapter There are large-scale businesses in India in railway transport, in banking, and insurance, in jute manufacture, in cotton and woollen manufactures, in the production if iron and steel and coal, etc , but no trusts, not even kartels

Large-scale and small-scale production in India.

In India, common observation (confirmed by statistical investigations) shows that large-scale business has made considerable progress in replacing small business and will continue to make progress in industries producing goods and services of standard types for which the demand(and so the market) is large and expanding , and in the manufacture of such standardised goods and services having a large demand, large scale has substantial advantages over small scale in the use of machinery, division of labour, management, purchase of materials, marketing of products etc

In India large-scale production is replacing small-scale production

(1) *in the transport industries*—steamers and railways replacing great numbers of boats, bullock carts, etc

(2) *in the mining and metallurgical industries* relating to iron, coal, gold, petroleum, etc

(3) *in many manufactures*, e g large-scale sugar factories, oil mills, flour mills, woollen, jute and cotton mills, etc , producing on a large scale the necessaries and prime conveniences of life of the mass of the people (for such commodities the demand is large and the market large and expanding) have replaced a great deal of small-scale production

(4) *in insurance and also banking* (the Imperial Bank with its huge capital and numerous branches being a recent remarkable instance of large-scale development in Indian banking)

(5) *In retail trade, and also in agriculture, little or no progress has been made in India in large-scale production*, and such progress specially as regards agriculture will be very slow (if there is any progress at all) for the reasons noted on page 271

In India, in spite of the progress made by large-scale production, small-scale production shows remarkable vitality (as already indicated) *and it occupies practically the whole field in agriculture and retail trade and employs a vastly larger number of industrial workers in its small industries than those employed by railways, mines and large-scale factories*, and small-scale production still supplies the greater part of the wants of the whole population For preventing catastrophic economic disorganization (which will result in great sufferings for millions), and for artistic, moral and social considerations, small-scale production should be helped to maintain and improve its position—and the growth of co-operation, better technical training, modern tendencies in machine development and the increasing diffusion of trade knowledge will make possible a supremely useful future for many small-scale industries in India and elsewhere

Let India by all means have its large industries and in good time and wherever economic conditions make these necessary

or inevitable—but by no means India should neglect its small-scale industries (old and a few of them new) with their useful economic features, and extremely valuable artistic, moral and social quality (Refer to pages 263-268)

A new stage in large-scale production—giant business (horizontal and vertical combinations).

During the present generation, a new stage of large-scale production has been reached, in the United States of America chiefly and to a substantial extent in Germany and Britain large-scale production is developing into what may be called *'giant business'* Some years ago, a large-scale business was almost always concentrated in one place, with its factory, labour, capital, machinery, but a modern 'giant business' of the American type has many large factories and establishments (each with its own materials, machinery and executive) in different parts of the country and engaged in the same or related branches of a great industry under the same supreme management and financial control *As Prof Taussig points out it is better to call it large-scale management than large-scale production*

This system of large-scale management is found in the Trusts of the United States of America and to some extent in the Kartels of Germany (For a discussion of Trusts and Kartels and their advantages and disadvantages refer to pages 318-325) This large-scale management takes two forms

(1) *Vertical combination (or what is called the integration of industry)*

When the different successive stages in production in one industry are united under one management, we have vertical combination or integration of industry

Perhaps the most prominent example of vertical combination is the United States Steel Corporation which has its own mines of iron ore, of coal, etc , it smelts its own ore, carries its ore and coal by its own railways and ships, and converts the pig-iron made in its own furnace into steel, and then converts steel into rail, plates, sheets, tubes and wires and all other kinds of steel products So in this Corporation, all stages in the production of steel goods (from the production of the raw materials to the finished steel products) are united under one management

Vertical combination is a conspicuous feature in the iron industry in the United States, in Germany and to some extent also in England, and the Tata Iron Works in India is also a good example of vertical combination

A very suitable field for vertical combination lies in those indus-

tries in which supplies of raw materials are concentrated in a particular area and the comparative ease with which the supply of raw materials can be controlled leads to vertical combination in such industry

The tendency towards vertical combination is not so powerful as the tendency towards horizontal combination

(2) Horizontal combination.

Horizontal combination is a combination of several enterprises of the same kind under one management

With the growth of large-scale production, the size of the representative firm in an industry increases and the number of firms diminishes, till only a few large firms are left, these few large firms engaged in the *same industry* (*e g*, the sugar refining industry, the steel or any other industry) are then combined under the control of one management

Causes of horizontal combination.

The reasons for horizontal combination are (i) that economies can be secured in this way in connection with transportation of raw material, repair and replacement and working of its standardised machinery in its different establishments and other economies in connection with management

(ii) and also such combination may largely limit competition and bring about a more or less effective monopoly

Jaussig remarks "horizontal combination is typical of the so-called trust"—the trust often embodies the principle of horizontal combination

A conspicuous example of horizontal combination is the American Sugar Refining Company which has been formed by the combination of many large sugar refineries under one management Another important example is the Steel Corporation which owns and manages many steel mills

The United States Steel Corporation is a case of horizontal as well as of vertical combination, and so is also the American Tobacco Company, and in many other cases it will be found that horizontal combination and vertical combination go together

The movement towards combination of different kinds is now very powerful in the United States, and also in Germany and to some extent in England and France, but not in India, for in India the development of large-scale production has been much later and much less than in these other countries It is most powerful in railroads and other forms of transportation, less powerful in manufactures and mining and least so in agriculture

Some of these combinations are gigantic affairs For example, the United States Steel Corporation own "78 blast furnaces, with a capacity

of upwards of 6,500,000 tons of pig-iron yearly, or half that of the United States in 1900, 149 steel works and six finishing plants with an annual capacity of about 9,000,000 tons of finished materials, 18,300 coke ovens, about 70 p c of the ore mines of the Lake Superior region, producing, in 1900, 12,724,900 tons, 70,880 acres of coal lands 125 lake vessels etc" (See also Jenks—*The Trust Problem*, Appendix F 1909 edition)

Future of large-scale production.

(A) Large-scale production in agriculture.

As regards the evolution of agricultural production in the future, Prof Gide points out that the tendency of agricultural evolution is from extensive to intensive cultivation and he expects that the agriculture of the future will assume more and more the form of small farms, farms becoming smaller and consequently more numerous and united by the ties of co-operative agricultural associations

Intensive cultivation owing to its greater cost of production increases the amount of wages to be distributed and it also increases the actual quantity of food-stuffs, and having regard to the growing population of the world it is suggested by some that gradually intensive farming, which will produce a greater quantity of food, must more and more displace extensive farming—otherwise there will not be enough food for the world's population

Prince Kropotkin in his extremely interesting book "Fields, Factories and Workshops" has emphasised the great importance of intensively cultivated small farms in the agriculture of the future

Soviet Russia, however, is experimenting successfully with agricultural farms on a gigantic scale

(B) *As regards the future of large-scale production in manufacture and commerce*, small-scale businesses are not likely to disappear altogether

(i) *From the point of view of production*, small industry is not always inefficient Again in some industries, a combination of small producers by co-operation among themselves would be almost as effective from the point of view of productive efficiency as large-scale production, and this combination would at the same time retain those advantages which pertain peculiarly to production on a small scale by small enterprisers

(ii) *Then as regards distribution* The system of production by small producers is held to be more favourable to a proper distribution of wealth and therefore to social peace than production on a large scale

This however may be disputed Conflicts between capital and labour are not always absent from the establishments of small producers

Even in industries and enterprises best suited to concentration, the tendency to large-scale production cannot continue to an indefinite extent, nature imposing definite limits, and the reason is that beyond a certain point economy resulting from large-scale production disappears and the proportion of costs increases rather than diminishes

Socialists and large-scale production.

The tendency to large-scale production and 'giant business' is favoured by the Marxian socialists—they hold that as soon as the law of concentration has gathered the work of production into the hands of a few individuals and has made the rest of the nation mere wage-earners then the transition to collectivism (socialism) will be easy A slight shock will be quite sufficient to overthrow the capitalistic structure based upon a few large-scale employers and then socialism will be established

A Note on Rationalisation.

Rationalisation, its difficulties.

What is Rationalisation?

The idea (the application of reason and commonsense to production and the proper adjustment of production to consumption in systematic and scientific fashion) is a comparatively recent growth, developed to an important extent in the reconstruction period after the last World War

The word, *rationalisation,* comes from Germany

Rationalisation has been more thoroughly practised in the United States of America and Germany and somewhat less so in England

A Definition of Rationalisation

"In the old days we had the application of commonsense to production, and I think it is one and the same thing As rationalisation is perhaps a new word, it requires a definition It really is the method of technique and organisation designed to secure the minimum of waste, in effort and material, added to that, the scientific organisation of labour, the standardization of materials and products, and the simplification of processes and physical improvements in the system of transport and marketing "—*Sir Arthur Balfour*

*Essentials of Rationalisation Advantages claimed for Rationalisation

A country may have many industries—coal mining, manufacture of iron and steel, cotton manufacture, jute manufacture, chemical industries, etc

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*"The Second Industrial Revolution

The thesis of this article is that the advanced industrial countries of the world are now in the first stage of a sweeping change of the

"Stripped of everything extraneous, there are two main points First we have the adjusting of production to consumption, one of the chief troubles in the economic field at all times, and specially to-day, is the difficulty of adjusting production to consumption in such a way that either an overproduction which results in a fall of prices, making the whole of industry bankrupt is avoided, or so that shortage which induces intolerably high prices and thereby inflicts great suffering on the consumers does not occur

Rationalisation of an industry implies that as regards this industry production should be properly adjusted to consumption within the country and as far as possible also on an international scale, that the industry as a whole should be made as efficient as possible and that separate business units and firms in the industry should be made as efficient as possible Weaker units are to be eliminated, and the stronger units amalgamated to form larger units wherever required in the interest of efficient production Obsolete plant and inefficient methods must be scrapped, adequate capital and high grade business ability must be provided to make the business units (mines, factories, etc) most completely equipped as regards plant, machinery, materials, methods, there must be scientific management of labour, and also efficient marketing arrangements must be secured There must be co-

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methods and organisation of all their secondary industries, and that this new movement is likely to be comparable in its industrial, commercial and social effects with that series of changes which commenced in the latter half of the eighteenth century and is commonly called the Industrial Revolution The changes are coming about as the result not merely of the application of scientific knowledge to industry, which was, in fact, the last phase of the first industrial revolution, but of the use of the inductive method in the study of an industry, and individual concerns composing it, with a view to gaining facts and generalisations which may serve sooner or later as the basis of the replanning of the productive process and plant The essence of the new industrial revolution is the search for exact knowledge, and the planning of processes from the minutiæ of manual operations (based on motion study) to the lay-out of the machinery of a gigantic plant—even of a whole industry throughout the country The trade and social results are to some extent different according to whether the industry is replanned and rebuilt under conditions of free competition or of monopoly, and in the latter case according to whether the monopoly is in private or public ownership—and absolute or partial The effects upon wealth production and its distribution vary considerably according to the nature of these conditions, but it is arguable that one ultimate effect will be a stimulus to public ownership and operation of industries

Rationalisation

In the after-war reconstruction the importance of the new American methods—continuous production, specialisation, the replanning of plants, adoption of Taylor's principles and methods, personnel management

operation between the different business units in an industry—also co-operation between different industries in the same country

Co-operation between industry, trade, banking and finance and the State is essential in the rationalisation of the economic life of the country as a whole The interests of producers are to be safeguarded, also the interests of labourers and consumers In these days of world competition and co-operation, rationalisation will generally require for its success a measure of *international co-operation*

"It is obvious that unless you know with fair accuracy what the country will produce, what the production of the world is going to be, you cannot get the rationalisation of production to consumption, which is required for economic prosperity It is also fairly clear that unless those engaged in production are prepared to stabilize, to co-operate either with the restriction or the development of production in some manner on a fairly large scale, you will get what we see in the world now, a continual zigzag either of over or under production and over or under consumption

Take, for example, the coal industry Anyone who analyses it will see that if you produce more coal than the world wants you arrive at

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and ndustrial psychology—was more widely recognised by German industrialists than by English A great movement of reorganisation of industry on the new bases of efficiency commenced, and a few years later came to be known as "rationalisation" This term is appropriate because the transformation of industry which it denotes is based on reason throughout, being a replanning of equipment and labour methods on the basis of observations and estimates having a scientific basis There appear to be five features essential to the rationalisation of an industry —

(1) Amalgamation or unified control of companies and elimination of weak concerns, so as to secure control of the market, and thus facilitate on the basis of monopoly profits the raising of the large amount of new capital necessary,

(2) Specialisation of plants and their re-equipment so as to reap the maximum economies of large-scale production, both in respect of machinery and of organisation, and the building of large new plants for products in the manufacture of which the utmost economy can be reached only in this way,

(3) The planning of each plant for continuous production with specialised machines and tools,

(4) Specialised management, largely functional, including careful buying, grading and mixing of raw materials,

(5) Perfection of manual operations on the basis of time and motion studies, with necessary instruction

All these are ways of reducing either prime or supplementary costs their relative importance varies according to the product and prevailing conditions"—Prof H Stanley Jevons, *The Second Industrial Revolution*, in the *Economic Journal*, March, 1931

an uneconomic price, and that unless you succeed in obtaining some kind of combination which regulates production with consumption that state of things is likely to continue for an almost indefinite period, much to the detriment of all those concerned in the industry although perhaps to the benefit of those who consume its commodities From this premise flows naturally the idea of amalgamations, trade combinations, of national and international cartels and combinations Intelligent industries have really co-operated more or less on these lines for a number of years, the less intelligent still go on cutting each other's throats, and wonder why they do not make as much money as those which are intelligent

I must confess I myself was driven to this line of thought and action by the fact that unless British industry succeeds in arriving at a measure of large-scale organization it will find it extremely difficult to keep its position and to face, the competition of the great combinations of the Continent and America I certainly came to that conclusion as far as the chemical industries are concerned, and I believe it is correct for a number of other industries in this country"

Advantages claimed for Rationalisation

You can rationalize, with very considerable advantages, by well-conceived and well-carried out combinations You provide for instance a large measure of common finance It is obviously easier to obtain finance for large interests than for small ones You can provide in a large measure for common research You can provide, if you have the means, for the best management obtainable, because you can afford to pay larger salaries, which will form a smaller part of your general expenses than in a smaller business You have this pooling of knowledge, by the large number of expert men employed, and also, you can work out large schemes for dealing with your labour problem You have these advantages One other advantage is that you are in a position to deal with authority with the industries of other countries

I mentioned coal I have also expressed the view that coal is an international question, not national, and everything confirms my view To-day it is a European problem, and every country in Europe is in the same difficulty It has really to be solved by some kind of arrangement amongst the European coalfields, otherwise you will get a continual demand to depress wages, lengthen hours, a dismal long road of unemployment and disappointment in every way, with all its subsequent disadvantages"—Sir Alfred Mond's speech in *World Prosperity and Peace*, 1928

Rationalisation, its difficulties

Rationalisation has its serious difficulties Even in an economically progressive country like England,* the difficulties in the path of

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* Refer to *Problems of Rationalisation* in *The Economic Journal*, September, 1930

rationalisation are substantial and have led to much discussion and controversy

The attempt to rationalize an industry will rouse opposition from some employers and will be often unpopular with labourers The inefficient employers of inefficient firms are eliminated by rationalisation So they oppose rationalisation Rationalisation introducing more efficient plant, machinery, methods and organisation often reduces to a great extent, the number of labourers employed in an industry This leads to labour opposition In fact, one of the causes of the present world economic depression is rationalisation swelling the figures of unemployed labourers in all leading countries Also the provision of adequate capital, required for rationalisation, has led to controversy between bankers and industrialists in England

Rationalisation can never be a success without high grade ability in business management A country without a sufficient supply of capable business leaders will not be able to rationalise its industries Mere amalgamation of business units (mines or factories, etc) without efficient business management is no true rationalisation

Its Disadvantages

Even when an industry is rationalised under capable business management, there may result some important disadvantages

The rationalised industry may establish a monopoly and charge unduly high prices to consumers The State and the Nation cannot ignore this kind of exploitation of the consumers

Again it may lead to extensive replacement of labour and unemployment The State and trade unions are deeply interested in this aspect of the problem

Of course, in an ideal scheme of rationalisation the interests of consumers are properly safeguarded and the hardship to labour may be minimised by shorter hours of labour rather than unemployment Such ideal schemes are difficult to realize in practice

Rationalisation, Nationalisation, International Co-operation

In an industry under certain circumstances, rationalisation will lead to nationalisation

For example, as regards the British coal industry wasteful competition and lack of proper co-operation among mine-owners have brought about the development that many competent observers (not all of them Socialists) are of opinion that the coal industry will not be organised satisfactorily unless nationalised with the workers having a share in the management of the industry

Socialists hold as regards industries in general that true rationalisation securing adequately the efficiency of industry as well as the interests

of consumers and labourers will be found only in nationalisation For them rationalisation is nationalisation This is the programme (already largely realised in practice) of Soviet Russia

In capitalist countries as well as in the socialist state, rationalisation under present conditions of world competition and co-operation, will not attain its full advantages without a proper measure of international co-operation, as regards adjustment of production to consumption and satisfactory labour conditions and monetary arrangements

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CHAPTER VIII

LARGE-SCALE PRODUCTION. SMALL-SCALE PRODUCTION.

Summary.

1. Large-scale Production.

1 Large-scale production is a striking and characteristic feature of the modern industrial organization

Under proper conditions large-scale production has advantages for (*a*) consumers (*b*) work-men (*c*) producers (*d*) and society as a whole

Advantages.

In many industries, large-scale production enjoys a great superiority over small-scale production as regards (i) economies from division of labour (ii) economies of machinery—greater specialization of machinery and the large use of the latest and most up-to-date machines, economy of motive power, also experiments (iii) economies of purchase and sale, and the utilization of waste products (iv) economy of space A large firm has also certain other purely competitive (as distinguished from productive) advantages

Limits to Large-scale Production.

In a particular industry, the ultimate limits to the growth of large-scale production are to be found in (i) the nature of the market (ii) the capacity and energy of the employer

2. Small-scale Production.

There are healthy and unhealthy forms of small-scale production

In some industries small-scale production is the rule, it still flourishes In these industries either the economies of large-scale production are not considerable or are neutralised by other factors

Advantages

The small-scale producer benefits by (i) the economy of the master's eye (ii) some recent tendencies in machine development (iii) the growth of co-operation, and (iv) the spreading of trade knowledge through newspapers, trade and technical journals, etc

3 Large and small farms.

Large farms have some advantages relating to (1) the use of land (2) the application of capital—in farm buildings, machinery, etc (3) division of labour (4) experiments, inventions and the utilization of by-products For crops, flowers and other produce requiring special skill, care and attention on the part of the farmer, the small farm has its advantages

Special limitations in the case of agriculture make the growth of large-scale production much less considerable in agriculture than in manufactures and other industries

4. Progress of Large-scale Production—its extent.

The tendency to large-scale production is most powerful in the transport industries—railways, steamship lines etc , also in mining and many manufactures, also in banking and insurance Large-scale production has made much less advance in retail trade and its progress in agriculture is inconsiderable

QUESTIONS.

1 What are the advantages of large-scale production? What are the special advantages on the other hand of the small producer? (A U 1894 C U 1911, 1919)

2 Consider the advantages and disadvantages of farming on a large-scale and on a small scale Indicate the limits to large-scale production in agriculture Refer to Indian conditions

3 Write a note on the present position of large-scale production in modern industry, indicating its extent and importance

CHAPTER IX

INDUSTRIAL ORGANIZATION (continued).

Business Management.

In the language of the modern industrial and commercial world, 'business' includes all provision for the wants of others which is made in the expectation of payment direct or indirect from those who are benefited—*business means profit-seeking by supplying the wants of others* And profit-seeking under modern competitive conditions implies the taking of risks , to get profits by supplying others' wants a man must also incur the risks of loss

The manufacturers who make things, the wholesale merchants who buy from the manufacturers and sell to the retail traders, and the retail shopkeepers themselves—they are all engaged in business for they buy and sell with a view to profit But take the case of a large-hearted benefactor of the poor—he also supplies the wants of others, but not for profit This is something higher than business, but it is not business

The management of business is one of the most difficult questions of business organization and it is one of fundamental importance, for *the success or failure of a business depends in great part upon the quality of business management*

Types of Business Organization.

Business management to-day has many forms A strictly logical classification is neither practicable nor convenient, but the important varieties are indicated below

1 The single entrepreneur system—*one-man management*

2 The partnership system—*management by two or more partners*

3 The Corporation (or Joint-stock Company)—*a sort of oligarchical management,* a few managing on behalf of the many

4 Monopolies, Trusts, Kartels—*management with a view to monopoly*

5 Co-operative associations—*democratic business management* (i e the many managing on behalf of the many)

Partial applications of the co-operative principle are found in profit-sharing, etc

6 Government undertakings—*management by a government department*

Of the different forms of business organization, the three most important at the present time are the single entrepreneur system, the partnership and the corporation The question of government management, already one of great and increasing importance, has received an immense impetus from the vast experiments in government management, and control of business made by the rich and powerful nations engaged in the last World War

Before discussing the different modern types of business management, it will be necessary to give some account of the rise of the modern entrepreneur class

The Entrepreneur.

(The man who controls a business, who organizes it and undertakes the risks (of profit or loss)—he is known as the entrepreneur)

A salaried manager does organizing work more or less , but he is not an entrepreneur for he does not undertake risks, the risks are not upon him but upon his employer

The entrepreneur or employer (he is also sometimes called the *undertaker*) does not necessarily supply all the capital required for his business, he borrows a great part, perhaps the greater part of his capital from capitalists, banks, etc , then he rents land, employs labourers, buys his raw materials and organizes the work of production Indeed in the United States of America where business is on a large scale and very complex requiring high business capacity for its successful management, really capable business men are in such great demand, they are

able to get any amount of borrowed capital for their industrial enterprises But in India with her industrially backward condition, the facilities for borrowing are much smaller and able business men with insufficient capital are thus seriously handicapped and national industrial development greatly suffers in consequence

Rise of the Modern Entrepreneur (or employer) Class.

The rise of the modern entrepreneur class is a most interesting and important chapter of modern economic history

In this age of specialization the modern entrepreneur is a specialist in business management As one economist puts it "The management of business has itself become a business" *The evolution of the industrial organization brings about increasing specialization—of different localities for different industries, specialization of machines and of men When business is simple, as in early stages of industrial development almost any one with some capital can do it, but as it grows more organized and complex as under modern conditions, men specially qualified for the work of business management are wanted*—men who have a special capacity for managing a business, though they may not have much physical strength or technical skill or any capital

In the earlier stages of industrial history an entrepreneur class of the modern type did not exist for the forms of production were few, the raw materials were simple, only hand tools were used, division of labour was not so largely developed as under the modern system, the markets were small and there were only a few standard patterns of manufactures and no sudden changes of fashion and demand—in short when the management of production was comparatively simple and easy not requiring great qualities of mind and character, then an entrepreneur class of the modern type was not wanted

When hand tools and small workshops were replaced by powerful machines and large factories, when division of labour was highly developed and many persons of different degrees of skill and strength came to be employed in a factory each

knowing his own part of the work and perhaps not one employee understanding the whole work of production carried on in that factory, when methods of production (i e supply) are rapidly changing, and also demand and fashions, when production (i e. supply) no longer waits for orders but anticipates demand, when the raw materials are to be brought to the factory from the different parts of the world and the products manufactured in the factory have to be sold in all quarters of the globe—in fact when the evolution of industry of the complex modern type (with its factory system, machinery production, minute division of labour, changing demand and fashions and production for distant markets) makes the management of production extremely complex and difficult then an entrepreneur class consisting of business experts especially qualified by natural aptitude and training for the management of production becomes an absolute necessity and gradually comes into existence

Business of the modern type is complex, it is difficult, and it requires for its management a class of experts, persons who are specialists in business management

This is the origin of the modern entrepreneur class

The Entrepreneur—his functions, services and his importance in modern industry.

(*A*) *His functions and services*

The entrepreneurs have been rightly called *the captains of industry*—they are the leaders who organize and command the armies of industry in the work of production and in this way immensely increase the efficiency of production in modern industry and render services of very great value to society as a whole

The principal functions of an entrepreneur are (*a*) *organizing* (*b*) *risk-taking*

(*a*) *As* organizer, he controls the policy of the business,*

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* The entrepreneur has been compared to a war minister, and his is a double warfare (1) with rivals (trade competitors) outside (2) and civil war at home

the entrepreneur decides what things (and on what scale) he will produce, and by what methods they will be produced , he decides at what prices and on what terms the products should be marketed and what are the markets most suitable for them

As organizer, he co-ordinates the factors of production viz , land, labour and capital He decides in what proportions these factors are to be combined , he decides how many labourers of different sorts should be employed and what work they will do , he borrows a suitable quantity of capital and employs it for machinery, raw materials and other purposes which he thinks most suitable , and he rents land

(*b*) *Moreover the whole responsibility* of production is his, he undertakes the risks of the business* He gets his profit if the business succeeds and he gets nothing if the business fails He agrees to pay wages to labourers, interest to capitalists, and rent to the landlord whether the business succeeds or fails *He is the central figure in the distribution of wealth as well as in production*

By his capacity for organization, he saves much waste in connection with the production of wealth And by taking risks boldly and yet cautiously, with a firm and even temper he reduces his losses and increases his gains Thus he benefits himself by his gains and he benefits society by the waste which he saves through his efficient organization in connection with the national production of wealth

(*B*) *His importance*

Hence the importance of the employing or entrepreneur class, and the services rendered by skilful business management in modern industry cannot be over-estimated Upon the sagacity and energy of the entrepreneurs depends in a great degree the success of the industries of a country , and *"the armies of industry can no more be raised and equipped without their commanders than the armies of war"* Skilful business management by competent entrepreneurs in the different industries of the country enormously increases productive efficiency by organizing effectively the land, labour and capital

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* "The function of risk taking cannot be turned over to an employee working for a salary It is essentially the function of the business man himself" (Carver—*The Distribution of Wealth,* (Ch vii)

of the community , if there were no entrepreneurs, if by magic the entrepreneur class were suddenly to disappear then the present organisation of large-scale production under modern conditions would completely collapse and the land, labour and capital of the community constituting the army of industry would become a mere rabble drifting hither and thither and not knowing what to do , production would be utterly disorganized and would be almost brought to a standstill

The greater the efficiency of the entrepreneur class in a country, the greater will be its industrial progress and the higher will be its industrial position in the world The United States of America owes a great deal of its immense industrial prosperity to its exceptionally capable entrepreneurs or business experts , and the comparatively slow rate of progress in the industrial development of India is due more than Indians generally care to admit to the insufficient supply of competent Indian entrepreneurs)

Carlyle* calls these enterprisers the *captains of industry* To Walker, a distinguished American economist,† they are *the master class* in industry, the men who rule, upon them everything depends

The Future.

Indeed Walker further holds that the importance of mastership (*i e* the influence of the entrepreneurs) is going to increase rather than decrease in future, and that the industry of the world is thus not tending towards democracy but in the opposite direction The future is always uncertain Recent labour movements, an immense increase in the strength and solidarity of the labouring classes, and the growth of education and true co-operation give us the hope however, that the future may not belong to the masters alone , and that industrial democracy (the control of industry not by a few masters, but by the people and for the people) may become sooner or later an accomplished fact

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* Carlyle—*Past and Present* (Book IV Chapter IV)
† Walker—*Political Economy* (Part II Chapter IV)

Faculties required in the ideal entrepreneur.

The faculties which will enable the entrepreneur to discharge his important functions properly will necessarily be of a high order

The ideal entrepreneur (or employer) must have a twofold ability—he must have a general knowledge of the supply and demand of commodities in which he deals, also the materials and machinery he uses (rather than mere* technical knowledge of processes) (2) and a knowledge of human nature and a capacity for leadership among men

(1) As organizer of production he must be able to calculate the broad movements of *supply* of commodities and the *demand* for them in the markets of the world , must have the judgment to find out where there is a new demand for a new commodity or an enlarged demand for an old one, and also how to produce his supply at a lower cost by improving his processes and adopting new inventions and methods of production He should have the power to judge quickly and yet correctly about conditions of demand and supply , and he should not be afraid to undertake risks when required He must have a general knowledge of the raw materials and the machinery which are required in the industry in which he is engaged

(2) To get the best out of his men, the ideal entrepreneur must have a broad knowledge of human nature and he must have the gift of leadership, he must be a *leader† of men*

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* *But the entrepreneur need not always be a technical expert himself* as he can easily employ men with the required expert knowledge of machines and processes The mere technical expert is a good instrument in the hands of the entrepreneur, but he should not aspire to be an entrepreneur himself without a large knowledge of men and things —this is a lesson repeatedly brought home to us in India by the failure of many promising industrial enterprises

† *Leadership is now of the utmost importance in industry and commerce as in war* "In primitive times, a battle depends as much on the prowess of the best fighting men, of some Hector or Achilles, as on the good science of the general But now-a-days it is a man at the far end of a telegraph wire—a Count Moltke with his head over some papers—who sees that the proper persons are slain and who secures the victory *So in commerce* " (Bagehot—*The Postulates of English Political Economy*)

He should have the power of picking out the right men for the right jobs—he should have the power of choosing rightly as his subordinates different sorts of men qualified by aptitude, training and character for different kinds of work , and then he should be able to create an enthusiasm among them for the business and pride in their work and getting them to trust him as their leader so as to bring out whatever enterprise and initiative they possess He must have confidence in himself , he should have the power to inspire among his assistants confidence and a feeling of loyalty to himself and his business

And of course he must have *energy, enterprise, and organizing ability* of a high order, he must have the faculty of combining men and things in the most efficient way in the work of production—"he must exercise a general control over things and preserve unity in the main plan of business "

Bold and yet not reckless, if he is to succeed, cautious but by no means timid in his enterprises, the ideal entrepreneur must have sagacity and insight into the nature of men and things in a very high degree His insight sometimes amounts to foresight The entrepreneur of genius in many cases does things more by instinct than by reason—he knows what is the best to be done but cannot always tell why it is so

Business ability—how it can be increased.

Business ability (the entrepreneur's special contribution to production) is hence regarded as a distinct and important agent of production And how can it be increased in a country ?

It may be doubted whether the highest kind of business ability—constructive genius of the finest type—owes much to education , but with that exception, almost all other sorts of business ability can be fostered by education and are being fostered in Germany and America through the universities National education is indeed a great national investment

Entrepreneurs (or enterprisers) in actual life.

Enterprisers in actual life often fall far short of the ideal standard

The faculties required in an ideal enterpriser are so many and are of such a high order that there are very few individuals

who actually possess them all in a large measure It is generally found that some enterprisers excel in one set of qualities, other enterprisers excel in another Some owe their success to good qualities alone, many to a mixture of good and evil, and not a few only to a sort of harsh sagacity and methods of terrorism

Even the ablest business men are a good deal below the ideal standard Not intellectual failings alone, but also infirmities of the will, *e g*, recklessness and the other extreme, namely, an excess of caution lead to the misdirection of industrial power and loss of productive efficiency

Veblen's standpoint.

Veblen is very critical about the work of the business class (the employer class) in modern industry A fundamental theme of Veblen's whole scheme of analysis is the *antithesis between "business" and "industry"* "The motive of business enterprise is not maximum production of useful goods, it is pecuniary gain" "The aim and usual outcome is the accumulation of wealth" "The economic welfare of the community at large is best served by a facile and uninterrupted interplay of the various processes which make up the industrial system at large, but the pecuniary interests of the business men in whose hands lies the discretion in the matter are not necessarily best served by an unbroken maintenance of the industrial balance" (P T Homan, *Contemporary Economic Thought*, pages 150-151) Business is primarily sabotage upon production, and the income of the business class is chiefly derived from this sabotage Veblen has developed his standpoint in his well-known book, *The Theory of Business Enterprise*

Veblen, a great American economist, is no socialist He does not advocate socialism as a remedy

The Socialist standpoint

Socialists look upon the business leaders and employers in the light of exploiters, exploiting labour and society, and getting their profits from this exploitation They do not admit—at least extreme socialists do not admit—that the business leaders and employers are rendering useful services to society and getting their profits as remuneration for such services

Upton Sinclair and Sinclair Lewis on some business leaders in America.

Upton Sinclair and Sinclair Lewis, distinguished American novelists, do not give flattering pictures of some American employers in some of their well-known novels Upton Sinclair's *Oil* makes most unpleasant revelations as regards American industry and politics—corrupt industry corrupting politics

H G Wells on business leaders of the world

H G Wells in *The Work, Wealth and Happiness of Mankind* gives interesting studies of the careers of the Rothschilds, Cornelius Vanderbilt, Jay Gould, J D Rockefeller, Thomas Alva Edison, Henry Ford, Alfred Loewenstein and certain other persons and their services or otherwise to society and the cause of production "Ford, like Edison, is clearly a man of higher moral calibre than the examples we have taken before them His, too, is a mind dominated by constructive motives, by the desire to invent, and to invent in such a way as to lessen human labour"

Edison and Ford are men of high constructive capacity They have earned a great deal but have given much greater services to the world. But few industrial leaders are of this truly constructive type

Henry Ford as a business leader

"A manufacturer is not through with his customer when a sale is completed He has then only started with his customer A man who bought one of our cars was in my opinion entitled to continuous use of that car, and therefore if he had a breakdown of any kind it was our duty to see that his machine was put into shape again at the earliest possible moment In the success of the Ford car the early provision of service was an outstanding element

Concretely, what I most realized about business in that year—and I have been learning more each year without finding it necessary to change my first conclusions—is this

(1) That finance is given a place ahead of work and therefore tends to kill the work and destroy the fundamental of service

(2) That thinking first of money instead of work brings on fear of failure and this fear blocks every avenue of business—it makes a man afraid of competition, of changing his methods, or of doing anything which might change his condition

(3) *That the way is clear for any one who thinks first of service—of doing the work in the best possible way*

Throughout all the Ford industries we now have a minimum wage of six dollars a day

It ought to be the employer's ambition, as leader, to pay better wages than any similar line of business, and it ought to be the workman's ambition to make this possible

What do we mean by high wages, anyway?

We mean a higher wage than was paid ten months or ten years ago We do not mean a higher wage than ought to be paid Our high wages of to-day may be low wages ten years from now

If it is right for the manager of a business to try to make it pay larger dividends, it is quite as right that he should try to make it pay higher wages But it is not the manager of the business who pays the high wages Of course, if he can and will not, then the blame is on him But he alone can never make high wages possible High wages cannot be paid unless the workmen earn them Their labour is the

productive factor It is not the only productive factor—poor management can waste labour and material and nullify the efforts of labour Labour can nullify the results of good management But in a partnership of skilled management and honest labour, it is the workman who makes high wages possible"—Henry Ford, *My Life and Work,* 1931, pages 41, 46, 116, 117, 119

Henry Ford believes in *service* to be rendered to the consumer, in *high wages* to be paid to labour as fundamental things in all industry If millions of labourers in a country are getting high wages, they are able to buy more of commodities and services—so the trade and industry of the country prosper "No question is more important than that of wages—most of the people of the country live on wages The scale of their living—the rate of their wages—determines the (economic) prosperity of the country"—Henry Ford, *My Life and Work,* 1931, p 116

The remuneration of the entrepreneur, how he is paid—See the chapter on Profit in Book V on Distribution

I. The single entrepreneur system.

What monarchy is among governments, that the single entrepreneur system is among types of business organization *Here we have the rule of one man—the single entrepreneur controls the whole business* He may do everything for himself and work only with his own capital (*e g* lawyers, doctors), or he may hire workmen and borrow capital and work with these hired men and borrowed capital

Under this system, all the possessions of the entrepreneur including his private property of all kinds are liable for any debts incurred by him in connection with his business—*the legal liability* of the individual entrepreneur for his business debts *is thus unlimited* and extends to all his property

(A) *Advantages*

The advantages of the single entrepreneur system are obvious The man at the head of the business has the greatest incentive to secure efficiency and economy as the business is entirely his own and the gain would be all his own

(B) *Disadvantages*

The disadvantages of this form of business organization are (1) that one man is very rarely competent enough to direct successfully all departments of a large and complex business

(2) that the capital that one man can find for any business is generally small in comparison with the capital that can be raised by a number of men acting together (3) and the unlimited liability of the individual entrepreneur to some extent checks enterprise and experiments

The individual entrepreneur system (though sometimes found in large business) is suitable *generally* only for small undertakings which require capital and credit and business ability that can be supplied by the individual business man The single entrepreneur system still dominates the field in agriculture and small retail trade in all countries of the modern world

II. Partnerships.

The disadvantages of the single entrepreneur system are diminished to a considerable extent in a form of business organization known as the partnership

A partnership business is controlled and managed by two or more partners A partnership is an association of two or more individual entrepreneurs who are jointly and severally responsible for the management of the partnership business, for all its obligations and contracts

Partnerships are generally unlimited liability partnerships, (limited liability partnerships are also found in the United States and elsewhere)—each member of a partnership business is legally liable to the extent of all his property (whether invested in the partnership business or not) for all obligations contracted in the course of business by any other member of the firm

(A) *Advantages*

The partnership form of organization is suitable for businesses (1) which require a diversity of talents—the work of management may be divided, *e g* in manufactures one partner will devote his attention to purchasing raw materials and selling the manufactured products, and the other partner will look to the internal management of the factory itself , in a trading establishment one partner will manage the retail department,

and another will control the wholesale department and so on (ii) which require capital that cannot be raised by one man but can be raised by a small number of men forming a partnership

The partnership form of business organization is thus suitable for many businesses, and *it possesses, in a considerable measure, the elements of strength and flexibility* When a business long established is decaying, in the words of Prof Marshall "the oldest and the simplest plan for renovating the energies of a business is that of taking into partnership some of its ablest employees"

Private partnerships have played in the past a great part and they are still occupying an important place in the business world They are now generally found in the professions and also in certain kinds of manufacturing and commercial business of moderate size

(*B*) *Its advantages*

The partnership system has solid advantages if the partners work well together, and it has its many disadvantages if the partners have serious differences among themselves and cannot work well together, and this leads to disaster—as is too often the case in India *One great disadvantage of a partnership is unlimited liability—the risk for each partner is too great* For this and other reasons the partnership type of business organization has been replaced within recent times, largely by another form of business organization viz, the Corporation or Public Joint-stock Company

III. The Corporation or Public Joint-stock Company.

When production on a large scale reached a certain point, joint-stock companies came into existence in England and other European countries And the progress of the joint-stock system has been greatly helped by the adoption of the principle of limited liability which has diminished risks

The rule relating to liability was gradually relaxed in England in 1825 and again in 1844, and the full privilege of limited liability for the joint-stock company was not made

general in England till 1862 In this England has been the model and has been followed by other countries

Following the example of European countries, India has made some amount of progress in the establishment and working of joint-stock companies—in fact at present in India most of the railways, steamship companies, banks, mines, and large manufacturing establishments like cotton mills, woollen mills, jute mills, iron and steel mills, tea and coffee plantations etc are under the joint-stock system But *the development of the joint-stock system in India is yet much less than in Britain or America*

Definition

A corporation (or joint-stock company) consists of individuals known as stock-holders or shareholders who are the proprietors of the company having invested their capital in the company in the form of shares and who are legally authorized to elect a board of directors and through it to act as one legal person as regards its business

The shareholders are the proprietors and partners in the joint-stock company—but the joint-stock company is based upon the limited liability of its proprietors , while the ordinary partnership is based upon the unlimited liability of the partners

The Corporation a 'legal person' Limited liability

The Corporation (or joint-stock company) is one unit from the legal point of view It is a legal "person" by itself as distinct from the individuals who are the shareholders in the corporation The assets and the liabilities of the corporation affect directly only the corporation

The distinguishing mark of a corporation is its limited liability A shareholder's liability for the debts of the corporation is *limited* only to the value of his share in the corporation, all other items of property of the shareholder (*e g* his house, his lands, his shares in other companies etc) are not liable for the debts of the corporation The utmost that a shareholder can lose is the value of his share in the corporation and

no more *The corporation is thus a limited liability business* far as the shareholder is concerned, in a *partnership* on the other hand, *liability* is *unlimited*—every partner is liable to his last rupee, he is liable to the extent of his whole property including his houses, his lands and everything whether invested in the partnership business or not

Legal and economic differences between a partnership and a corporation.

To the lawyer, the difference is this—in a corporation (or joint-stock company) the liability of a shareholder is limited, in a partnership the liability of each partner is unlimited To the economist, the more important differences are the differences in size and management—generally the partnership is on a smaller scale and is managed by a few persons intimately known to each other, while the corporation is generally on a larger scale, the shareholders are many in number, most of them quite unknown to each other and the management is in the hands not of the shareholders but of a few persons elected or appointed by them

Corporation organization and management.

The shares of a public joint-stock company are sold in the open market and can be bought by any individual Every man who buys a share of the company becomes a partner in it (a partner with limited liability) and is called a shareholder **The shareholders** (in a big joint-stock company, in a railway for example there are thousands of shareholders) subscribe the capital of the business—**they are the proprietors, and they undertake the risks;** if the business turns out to be a success, the shareholders will get the profits, and if the business is a failure the loss will also fall on the shareholders

Though the shareholders undertake the risks, they do not in practice exercise very effective control upon the general policy of the business, and they take no part in supervising the details The general policy is controlled by **Directors** elected by the shareholders, these Directors are men belonging to different walks of life and they do not give their whole time to the business, but they are usually well-informed men of wide outlook and so they can give very substantial help by

their advice on general questions of policy and management Directors generally own some shares in the business **Managers** getting salaries and devoting their whole time to the business with qualified assistants superintend the details, they are supervised by the Directors who are ultimately controlled by the shareholders, though the control of the shareholders is not very effective

In a joint-stock company rights and responsibilities are thus divided—*the shareholders are the entrepreneurs and proprietors, they undertake the risks and raise the funds, the directors with their wider views look to the general policy, and the salaried managers have charge of the detailed management In law, the directors and managers are the servants of the shareholders and under the control and supervision of the shareholders, but in actual fact* the shareholders through want of business knowledge and experience exercise little control over their directors and managers

As Prof Marshall points out *"The expansion of joint-stock companies has resulted in the general democratisation of the ownership, as distinguished from the control of business"* (*Industry and Trade, Book II, Chapter VIII*)

[In theory the shareholder* is the master, in actual practice he is often only a sleeping partner in the business *As a matter of fact, the control and management of the corporation (or joint-stock company) is generally oligarchical*†—the directors practically choose themselves in many cases, they appoint the managers, control the policy, have everything in their own way, and generally manage to have everything sanctioned by the shareholders in their meetings *Nothing is*

* As a rule, the shareholder is a sleeping partner, who occasionally stirs in his sleep and delivers himself of more or less relevant utterances at meetings"—Withers, *Stocks and Shares,* (Chapter III)

† "The officers, salaried managers, etc, are chosen by the Board (of Directors) or by one another, and joint-stock companies are thus governed, in practical fact by a *self-elected oligarchy,* which is liable in extreme cases of mismanagement or misfortune to be turned out by a revolt among the proprietors (shareholders)"

"In form, therefore an economic democracy, with an elective responsible government *the joint-stock company is in most instances a close, oligarchy the monetary support of the public is wanted, but not their direction'*

—Hobson, *Evolution of Modern Capitalism,* Ch X

more remarkable and at the same time natural and instructive than the correspondence of economic and political institutions In the progressive countries of Europe, also in the United States, the form is democratic, but the essence is oligarchical —in government and also largely in business The few rule but they manage to make the many believe that they are ruling themselves Politically ruling power is in the hands of the professional politicians and the privileged classes, economically power is exercised by the directors in the corporation which is the dominant form of business organization]

In India, shareholders of joint-stock companies have much less of business knowledge and enterprise and so they have even less of control over the directors and managers than in the progressive countries in Europe and America , and so the management of joint-stock companies is even more oligarchical in India than in Europe and America

Joint-stock Companies in India.

In India public joint-stock companies have not proved so successful as in Europe and America (i) partly because the *shareholders* (who are the proprietors) have very little knowledge of business and have not the minimum amount of enterprise and knowledge necessary to exercise any real check over the directors

(ii) And partly because in the other Indian provinces except Bombay, a sufficient supply of competent men to act as *Directors* of joint-stock companies is not available Mere lawyers or doctors without any business training and experience form a very considerable proportion of Company Directorates in these provinces Little wonder that such companies frequently come to grief

(iii) Also properly qualified Indians for *managerial posts* in joint-stock companies, men combining business capacity and business honesty of the requisite standard are few and not many

Unless a considerable improvement takes place in these respects, it would be idle to hope for any rapid development as regards the numbers and the quality of joint-stock companies under Indian management and control Indeed the large number of joint-stock company failures in Bengal has bred a suspicious temper among capitalists in this province, it has made them somewhat shy as regards investing their capital in Indian joint-stock concerns, and some improvement must take place as regards company management and control before Bengali investors in large numbers will again readily risk their capital in indigenous joint-stock concerns

(iv) The Indian joint-stock companies labour also under other disadvantages

For example, *Indian capital* finds a securer and more remunerative investment in land and other forms of real property, and the rate of interest realized by money lending on good security is also very high, and so it would be somewhat difficult even if the standard of company management was higher to secure large supplies of capital for the generally less remunerative investment of joint-stock companies and of course it is still more difficult under present conditions

In recent years there has been improvement in all these respects

Then again in other countries, joint-stock companies are helped in finance by *banks*, here in India the big European banks will not liberally finance Indian businesses partly because many such concerns are not always built on strong foundations, and partly on account of racial jealousy and other reasons And Indian banks able to finance adequately Indian houses of business do not exist in sufficient numbers and with sufficient resources

During the last company boom, a large number of English and Indian companies were started in India largely with Indian capital, many companies having capital amounting to lakhs of rupees, and some having capital running into crores But many of these companies (including a large number of Indian companies) have collapsed, partly because of the failure of the shareholders to keep proper control over the directors and managers, and partly because of want of efficient and honest directors and managers, and in part because of general depression of trade

The large agency firms in India.

A characteristic feature of joint-stock organisation of industry and commerce in India in all the chief centres of business is the presence of the large agency firms which are mostly European except in Bombay Some of these large agency firms or firms of managing agents in Calcutta are Messrs Gillanders, Arbuthnot & Co , Messrs Andrew Yule & Co , Messrs Bird & Co , Messrs Martin & Co , etc These agency firms take part in the import and export trade, and they manage industrial ventures all over the country and they control the majority of the cotton, jute and other mills, as well as of the tea gardens and the coal mines

This system of agency firms or managing agents (instead of ordinary company management under managing directors) had its origin in India (*a*) partly in the fact that these large houses were able to furnish financial assistance to companies

starting new industries (*b*) partly in the difficulty, in the case of companies under European control, of finding among the relatively small class of leading men of business available in India, directors especially managing directors, who will remain in the country long enough to guarantee the continuous supervision required for the successful management of such business The better-class agency firms have secured efficient management of industries under their control for long periods , but they have their defects in being too cautious to embark on new ventures, somewhat unwilling to follow new lines of development, and they have been inclined to develop commerce rather than industries

Capitalization of Corporations.

In theory, the capitalization stands for the money actually invested in the corporation by the shareholders , but as a matter of practice this is not always the case In practice, the capitalization is often an arbitrary affair not representing the actual investment of capital in the business but an arbitrary nominal sum different from the actually invested capital, the respective holdings of different shareholders being calculated according to the number of shares owned by them *The capital actually invested in a business may be* £100,000 *but the nominal capitalization may be* £200,000

Also we have to distinguish between (1) *authorised capital,* (2) *subscribed capital* (3) *and paid-up capital*

Authorised capital refers to the capital which the company is authorised under its constitution to raise, it does not in any way represent the actual funds of the business , *subscribed capital* refers to the nominal value of the shares actually issued and sold , *paid-up capital* refers to the capital actually paid by the shareholders to the corporation with reference to their shares—the subscribed capital of a company may be £200,000, but the paid-up capital may be only £50,000, if each shareholder has paid up only ¼ of the value of his share The authorised capital is generally much larger than the subscribed capital , and the subscribed capital is often larger than the paid-up capital

Corporation securities—stocks and bonds.*

(A) Shares or stocks.

The shares or stocks of corporations (*i e* joint-stock companies) can be divided into two main classes (i) *preferred stock or preference shares*, (ii) *common stock or ordinary shares* The dividend (*i e* the profit) on preferred shares must be paid before any dividend is paid upon the ordinary shares Sometimes in one company, there are several classes of preference shares—first preferred, second preferred and so on The preference shares are intended to meet the wants of the cautious investors (Then there are also often *deferred shares* which used to be sometimes called *founders' shares* By these shares the original promoters of the company manage to keep a large portion of the profits for themselves, while maintaining an appearance of reasonableness and great moderation in their demands)

(B) Bonds (debentures, etc.).

(A joint-stock company in addition to the capital raised from the shareholders in form of *shares or stock*, often borrows money from outsiders in the form of *bonds* (*debentures, debenture stock, etc*) on which interest is paid at a fixed rate There are different classes of bonds according to the different kinds of securities on which they are based Each issue of bonds is generally terminable, the principal borrowed being paid off by the company after a certain number of years

The shareholders undertake the risks of the business, and so it is said that the shares represent "entrepreneur interests" ; the bond-holders do not undertake the risks of the business, they will have their interest on their capital whether the business is successful or not, whether it is earning dividends for the shareholders or not—the bond-holders are only the creditors of the company and so the bonds are said to represent creditor

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* Stock is transferable in any amount, shares are always expressed in certain definite multiples, *e g* , a £5 share, a £10 share and so on Bonds are also expressed in definite multiples Stock again is always registered and inscribed while shares are often bearer securities

interests *The stock-holders and shareholders are proprietors of the company, the bond-holders and debenture-holders are its creditors*

In the industrially progressive countries of the world, and specially in the United States a great deal of ingenuity is exercised in dividing the securities of a corporation into many different classes of bonds (sometimes there are as many as twenty varieties of bonds) and three or four classes of shares But in India more conservative methods prevail and this extensive variety of bonds and shares of the same company does not generally exist

Variety of securities; advantages and disadvantages.

The *advantages from a great variety of bonds and shares* in connection with the same company are these (1) These different varieties of bonds and shares represent different sorts of risks carefully calculated to appeal to different classes of investors, (2) so investors have a large variety to choose from and the total selling value of the securities (divided into different grades to suit different classes of investors) of the corporation is greater than it would otherwise be

The multiplicity of securities has also its disadvantages, and some of them are of a grave character (1) The holders of one class of security, the holders of ordinary shares who control the corporation may try to increase the value of the kind of security owned by them for purposes of pure speculation by various unscrupulous and immoral expedients which may affect injuriously the other shareholders and bond-holders

(2) If the business turns out to be a failure, and if the corporation has to be re-organized, it would be much more difficult to decide properly about the respective claims of different classes of bond-holders and shareholders when there are many classes of securities than when the securities are fewer in variety

So the conclusion is this There should be sufficient variety of securities to attract different classes of investors, but there should not be an excessive multiplicity likely to lead to difficulties specially when the business is in a bad way In the United States perhaps they have too much of variety specially in connection with railway corporations, in India, generally speaking, we have too little

Over-capitalization. Water in the capital.

The capital of a corporation is sometimes used (1) to mean the selling value of the business, *the capitalized value of the income-earning*

capacity of the business, and this will include invested capital and among other things goodwill, also monopoly power where it exists (2) and in a stricter sense, sometimes it is used by business men to refer only to *the capital invested in the business*,

In many joint-stock companies it is found that the nominal capitalization of a company is much larger than the capital actually invested in the business (and sometimes the nominal capital is much larger than even the selling value of the business)

The nominal capitalization is made larger than the capital actually invested with the object of distributing large profits to shareholders without exciting criticism as to the excessive profits made If the actual capitalization amounts to £100,000 and if the profits made in the course of one year amount to 50 per cent of the actual capital, such profit may lead to public criticism, specially if the profits are made in a business enjoying a natural monopoly or in railways and in other corporations which exercise semi-public functions To escape the charge of making excessive profits, a company would have a large nominal capitalization, *the actual capital may be* £100,000 *but suppose the nominal capitalization is made* £500,000, and the company distributing its profits among the shareholders would pay 10 per cent on this nominal capitalization but really the company would be paying an excessively high dividend of 50 per cent on the actual capital, and the public not knowing the actual capitalization would be deceived into believing that only a moderate dividend of 10 per cent was paid

Advantages of the corporation (the public joint-stock company) as a type of business organization.

The limited liability of the shareholder, the transferability of shares, their small value, and the system of management by directors and managers—these features of the corporation make it superior to the partnership and the single entrepreneur system for many purposes (specially in large undertakings), and produce important advantages for the individual shareholders and also for society

1 *Some advantages to shareholders and to society*

(1) *The limited liability principle is a great advantage in the following ways*

(*a*) *It diminishes risks of shareholders* Men who are too timid to engage in partnership business where liabilites are unlimited would be glad to join corporations where the liability of a shareholder is limited

(*b*) *It is suited for risky and experimental enterprises.* The liability of shareholders being limited, they can venture to invest considerable sums of the corporation money in experiments, they can also afford to engage in risky undertakings The experiments if successful will not only produce large profits for the shareholders of the corporation, they may also bring about improvements in productive processes which will immensely benefit society as a whole

(ii) The corporation issues shares generally in units of small value, and of different kinds, it thus offers an immense variety of investments suited to the capacities and tastes of an immense variety of investors, and such variety is not afforded by other forms of business organization, *viz*, the partnership or the single entrepreneur system

(iii) Again the shares are easily transferable The shareholders are free to leave the corporation by selling their stocks and shares at any time they like, and men are also free to enter the corporation any day by buying its stocks and shares, such freedom is not possible in the partnership or the single entrepreneur system

In all these ways, investors are attracted as shareholders to the corporation form of business

(iv) The ease and facility of investment resulting from transferability, the limited liability and also the great variety of corporation securities stimulate saving, increase the growth of capital and thus benefit the community

II *Stability, also efficiency and flexibility of management*

(i) A business under the single entrepreneur system or under partnership management and ownership depends for its life and success upon the life of one or two individuals, but a corporation has more permanence and stability

(ii) The corporation may profit by the valuable advice of highly qualified directors on broad general questions of policy and in this way a great increase in the efficiency of the business can be secured, if the directors are honest and are suitably qualified, but many of these directors will not be induced to undertake the risks involved in partnership business

(iii) A certain amount of flexibility in connection with management is also secured under this system If the management is inefficient, the shareholders have the power to remove the old directors and managers and appoint new and more competent ones

Also the posts of managers and their assistants in joint-stock companies afford considerable opportunities to men who have natural talents for business but who have no capital of their own to start independent enterprises This is an important gain

III *Suitability for large businesses*

Many modern enterprises (e g large railways, big steamship companies, etc) require such a large amount of capital that generally it would not be possible to raise this large capital from one or two individuals , but a corporation with its many investors (sometimes a corporation has thousands of shareholders) will be able easily to raise the large amount of capital required for a large undertaking

The corporation form of business organization has thus facilitated large-scale production and has in this way helped greatly the development of industry

Disadvantages of the corporation system.

The corporation form of business organization has great advantages specially for large enterprises and also other enterprises where the risks are considerable , and it offers many attractions to investors of different classes

It is not, however, without certain disadvantages of its own

(i) *Rash enterprises undertaken*

The *limited liability* of the shareholders reduces their risks in becoming members of the corporation , and this sometimes leads them to undertake excessively speculative enterprises

(ii) *Sense of mutual support among shareholders, etc , weakened*

The easy transferability of the shares has led to the disappearance of a sense of association and mutual support for

common profit and common loss, as soon as the more intelligent shareholders find that the affairs of the corporation are in a bad way, they will sell their shares and go out of the corporation leaving the less intelligent and the less enterprising shareholders to bear the burden of loss This is certainly not up to the highest moral standards

Again the easy transferability of the share of a corporation makes it possible for dishonest directors and other men with "inside" information about the business to buy shares from shareholders or to sell shares to them under conditions and at prices which victimise these persons This is often done and it is a very serious evil

(iii) *Diffusion of responsibility with risk of mismanagement.*

In a corporation, the work of control and management is divided between three parties, (1) the shareholders who find the capital and undertake risks, (2) the directors who are not whole-time men and who advise on broad questions of policy and (3) the salaried manager and his assistants The work being divided, the responsibility is also divided in the corporation

And the absence of adequate knowledge of business often makes the shareholders the victims of dishonest directors and managers The history of many recent joint-stock companies in India furnishes a melancholy commentary upon this proposition

(iv) *Distance between the employers and employees*

The corporation form of business organization has immensely increased the distance between the employers and the employees The shareholders are the employers, they live, the vast majority of them, at a distance from the locality where the corporation is situated and they have practically no personal relations with the employees of the corporation, they take little personal interest in the welfare of the employees and they are always looking to their dividends and how to increase them The friendly relations between the master and his workmen which often existed under the old system have disappeared

under the corporation organization and this is intensifying the conflict between labour and capital

(v) Many evils in connection with corporations relate to *disregard of public welfare*

Individual entrepreneurs and partners have generally some moral standards, corporations often have practically none

The disregard of public welfare by corporations is to be found not only in the economic sphere but in the political sphere as well, and it is to be found in a more acute form perhaps in the United States than elsewhere In the United States and in other countries and in the United States more than in other countries, corporations by unfair competition strangle weaker rivals, charge unfair prices from consumers when that is practicable, bribe legislators and judges for their own ends and so on

Importance of the Joint-stock (i.e. corporation) form of business organization.

Notwithstanding some disadvantages attaching to the corporation system, the corporation or the public joint-stock company has played a very important part in industrial history during the latter half of the nineteenth century Prof Marshall* calculates that in the United Kingdom about a tenth of the business is done by these joint-stock companies and they have a total income of £250,000,000 , and it is estimated that a few years ago two-fifths of the business of the United States were controlled by corporations, and the proportion is increasing In India, the joint-stock system is still in its infancy , there are joint-stock concerns efficiently managed, some under European direction, and a few under Indian management—but the movement as a whole has not as yet firmly struck its roots in the soil, the people as yet have not developed in full the necessary aptitudes for it

Corporations have rendered and are rendering great services to society , they facilitate large-scale production and the econo-

* Marshall—*Economics of Industry,* (Fourth Edition, page 168)

mies in connection with it in banking, in transport and other industries, they stimulate inventions by their lavish expenditure upon experiments, by immensely increasing transport facilities, they have made possible a great development in industry and commerce and the enormous resources of big banking corporations have very powerfully helped the expansion of production and trade

If the defects attaching to the corporation system are kept under proper control by suitable legislative and other remedies, corporations will benefit not only their shareholders, they will continue to be of very substantial use to the community

Conclusion—proper field for the joint-stock (corporation) system.

Roughly speaking, the proper field for public joint-stock companies can be demarcated from the field for private businesses (*e g* partnership and single entrepreneur enterprises) in the following manner

The corporation form of business organization has been found to be specially suitable (1) *for large-scale enterprises requiring enormous capital* (*e g railways, shipping, banks, etc*) and specially those large-scale enterprises where prompt decisions are not necessary, where the management can be largely reduced to rule and routine, (2) *and also for enterprises in which considerable risks are to be taken and heavy sums to be spent on experiments* In businesses in which a moderate capital is adequate, and in which the conditions are rapidly changing and prompt decisions have to be made, private businesses with their greater flexibility of management are more suitable

In modern railways, steam navigation and other forms of transport, in banking, insurance, large manufacturing industries, also in mining, the joint-stock system is the dominant form of business organization, and it is in possession of a great part of the field in these industries

Joint-stock company management is *in essence oligarchical management, in theory* a few directors managing as the re-

presentatives of many hundreds or thousands of shareholders who own the joint-stock company but *in reality*, the directors generally do what they like, the shareholders being sleeping partners And so the joint-stock company—as worked by directors (or practically by managing agents in India) is often abused and often seriously neglects the interests of the shareholders (converting the shareholders into a proletariat of small capitalists), and as already noted the large joint-stock company often charges unfair prices to consumers and injures labourers by unfairly reducing wages

The defects of the large joint-stock company (which sometimes develops into a monopoly) have stimulated (1) co-operation among consumers and among labourers to protect their interests (2) and also a demand for government management (Refer to pages 326—331)

Co-operation with all its manifold blessings, economic, moral and social, *may come in much fuller measure in future, or more of government management* in industry (approximating to socialism)—*but at present in Europe and America, the joint-stock system* (including its development into Trusts, Kartels and other monopolies) *is still the dominant form of business organization*

History of the Joint-stock System.

Joint-stock companies are mentioned in Pali and Sanskrit books in ancient India

Joint-stock companies are mentioned by Sir Joshua Child in the seventeenth century, but they did not make much progress in England before the middle of the 18th century except the East India Company, and certain other companies for foreign trade

The opinion of economic writers was also unfavourable For example, the great Adam Smith,* writing towards the end of the 18th century decides generally against joint-stock companies, and maintains that they can be successful only in four cases—in the banking trade, in insurance, in the making and maintenance of canals, and in supplying a city with water And he lays down the limits of joint-stock activity thus—"The only trade which it seems possible for a joint-stock company to carry on successfully without an exclusive privilege, are those of

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* *The Wealth of Nations,* Book V, Chapter I

which all the operations are capable of being reduced to what is called *a routine*, to such a uniformity of method as admits of little or no variation "

Adam Smith's unfavourable opinion is due in large measure to the many failures of the joint-stock system of management in its early stage in Europe Similar failures (most of these under Indian management) have produced a great amount of distrust also in our country But as in Europe, with greater experience of joint-stock business on the part of the people and the growth of suitable intellectual and moral standards, the joint-stock form has become extremely powerful and its field has been widely extended till it is the dominant form in modern business—so it may be also in India in future The Indian people even now, are very honest in their own way, but they are not accustomed to joint-stock methods and the appropriate mental habits After all, the psychology of a people lies at the basis of its economic as of its political institutions

(i) *For the proper field and the present importance of the joint-stock system, see pages* 311-313

(ii) *For the advantages (limited liability and other advantages) of the joint-stock system,* which have made it of such wide and increasing importance, see pages 307—309 For some details about the present difficulties of joint-stock business in general and also specially in India, see pages 302, 309—311

The Financier Class.

The rise and growing strength of the financier class constitute a very striking feature of the present industrial organization One may call it a most significant (and also sinister) fact of modern industry and finance

In great part the financier is a product of the joint-stock company, and partly he has developed with the development of national borrowing by modern governments When people want to invest money in joint-stock business or in government loans, they consult the financiers, viz, bankers, brokers, promoters, etc, and act through them

The financier is the middleman between the investor and the entrepreneur (In a less developed business system, the entrepreneur himself borows directly the funds required by him)

The financiers in consultation with the entrepreneurs determine what companies shall be started, what mines, factories,

railways and steamship lines organized and equipped, what industries carried on, established or extended The Barings and the Rothschilds of England, the Rockefellers, Vanderbilts, and Morgans of the United States, the Beits and Barnatos of South Africa, the Tatas and Sassoons of India are some of the greatest financiers of the world

Their powers are enormous They control the entire industrial and commercial organization Their legitimate functions are extremely important But most of them have used their strength, not to serve society by performing their legitimate functions, but to levy an increasing toll upon the profits of industry They get most of the profits, and the investors get but the little that is left *

In some of the big monopolistic organizations, called trusts, it has been estimated that the cost of organization (including the pay of the promoter and financier), amounts often from 20 to 40 p c of the total amount of stock issued †

IV. Monopoly.

Monopoly businesses are most of them joint-stock companies or alliances of joint-stock companies——the trust (which is the common form of monopoly in America) is almost always a vast joint-stock concern, and the Kartel, the chief form of monopoly in Germany, is generally an alliance between big joint-stock companies , in addition to the ordinary features of large-scale joint-stock production, we have in these monopoly businesses the additional element of monopoly (Of course there are some monopoly industrial concerns which are not of joint-stock organization, and the individual's monopoly in a copy-right book or picture is an individual monopoly and not joint-stock)

The idea of monopoly will be best understood in relation to the idea of competition—complete monopoly exists only when competition is completely absent and partial monopoly may exist

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* The share of the proletariat of capitalists in the net gain of financial business is very small as compared to that of the magnates of finance" (Hobson—*The Evolution of Modern Capitalism*, Ch X)

† Jenks—*The Trust Problem* (Chapter V)

when competition though not entirely absent is present only in a very limited degree

The idea of monopoly involves the idea of absence of competition and it also implies unified management and control in the production of a commodity, in selling it or in buying it Buyers' monopolies are somewhat rare and so more attention will have to be paid for practical purposes to sellers' monopolies *The power to control price is an essential thing in a monopoly It is the surest indication that a monopoly exists*

Definition of Monopoly.

A monopoly is based on substantial unity of action on the part of one or more persons engaged in some kind of business which gives exclusive control as regards price specially and also as regards supply partially or wholly The essentials of a monopoly are thus (*a*) *substantial unity of action* and (*b*) *exclusive control specially as regards price*

A distinction is made between partial and complete monopolies *A complete monopoly* exists in any industry when the monopoly completely dominates the industry, when there is no competition at all , a *partial monopoly* exists when unified control of the monopoly is exercised over a large portion of the industrial field but not over a sufficient portion to give complete domination of the whole field The difference between a partial and complete monopoly is thus only a question of degree of control

Classifications of Monopolies.

Monopolies have been classified from many different standpoints , and some classifications are given below

(A) *Monopolies have been classified* into

(*i*) *Natural,* (*ii*) *Social,* (*iii*) *Legal* and (*iv*) *Voluntary—according to the source of their powers and the way in which they have come into existence*

The monopoly which originates from the fact that the sources of some valuable natural product are strictly limited

(and are monopolized) is a *natural monopoly* For example, if all the coal mines in a country are located in a particular district of that country, then that district has a natural monopoly of all coal in the country

The *social monopoly* may be defined as the monopoly which is inevitable for certain social (including economic) reasons Good examples of social monopolies are railway companies, gas companies and so on , in these forms of business, monopoly is almost inevitable, under certain circumstances on account of special social and economic reasons

Legal monopolies are those created by law, *e g* , patents, copyrights, etc (A social monopoly often has some legal monopolies to support it)

Voluntary monopolies come into existence from the amalgamation of rival businesses by more or less voluntary agreements

Monopolies have been also classified in other ways

(B) *Another classification of monopolies is based upon the area over which the monopoly extends*

(i) *Local monopolies* are those which cover only a small area Suppose a man manages to monopolize the sale of fresh milk within Calcutta—this would be a local monopoly

(ii) *A national monopoly* is one which extends over the entire area within which a nation lives A copy-right having force within one nation only but which has not been recognized by other nations is a national monopoly

(iii) *An international monopoly* is one extending over the areas covered by several nations

A copy-right which is recognized by many nations is an international monopoly Within recent times, some big attempts to establish international monopoly have been made, and of these one is the copper monopoly of 1889

The Standard Oil Company of the United States and the Atlantic Shipping Trust are two of the most prominent examples of attempts at international monopoly

The larger the area over which the monopoly extends,

other things being equal, the more significant and powerful is the monopoly

(C) *A classification based upon ownership will give*

(1) *Public monopolies which are owned and managed by some public body* and the benefits arising from the monopoly are appropriated by the public body and in the public interest

The public body may be either the state or smaller political units like municipalities and other bodies Nationalised railways, municipal waterworks, municipal gas-works, etc , are examples of public monopolies

(2) *A private monopoly* is a monopoly which is owned and managed by a private 'person'—it may be a private individual or a private partnership or a corporation consisting of individuals and which is not a public body acting in the public interest

In such a case the benefits arising from the monopoly pass directly to the private person though indirectly the public may benefit by cheaper prices and in other ways

(3) *A quasi-public monopoly* is owned by a public body but is managed by private persons There are some railways in India which belong to the class of quasi-public monopolies, they belong to the state but are managed by private companies

Monopoly price.

The problem of monopoly price (how the price of a monopolised article is determined) will be discussed in Book IV

Industrial combinations—Trusts and Kartels, etc.

Under monopolies, we have to discuss Trusts, Kartels and other forms of industrial combinations, for in them the element of monopoly power always more or less exists

(1) *The Trust—this destroys the individuality of the different businesses forming the combination*

In the Trust, the different businesses are united so completely as to form a single business

Trusts form a very conspicuous feature in the industrial life of the United States and some of the most important trusts* are the Standard Oil Trust, the Steel Trust, the Tobacco Trust, the Cattle Trust, the Sugar Trust, etc A big Trust is a big affair with a capital of many million pounds and engaged in vast operations Indeed the Standard Oil Company is an international monopoly

For certain special reasons† the Trust form of business has assumed greater prominence in the United States than in England and elsewhere

The monopoly power of Trusts is entirely a question of degree Some Trusts have it in larger measure than other Trusts

(2) *The Kartel—this is a looser form of industrial combination,* and it allows the different businesses joining the combination to retain a substantial amount of individuality and liberty

In the Trust the different businesses are merged into one business , in the Kartel the different businesses remain distinct and separate and they only enter into agreements and act jointly as regards specific points, viz uniform price and regulation of output *Unity of management is thus complete in the Trust, not so complete in the Kartel*

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* "The United States Steel Corporation is a unique aggregation of many giant businesses, but it leads rather than controls the steel industry The power of exceptional constructive ability, combined with astute destructive strategy, is illustrated by the history of the Standard Oil Company, its financial strength has gradually overshadowed a considerable part of American business Monopolistic control in the tobacco industry effects great economies in marketing"
Marshall—*Industry and Trade* (Book III, Chapter viii)

Mr Hobson points out that the tendency towards the formation of trusts, pools and other forms of monopoly is found not only in transport, manufacture, mining and finance but sometimes also in the world of intellect and art For example, the theatre in England and the United States is largely controlled by Mr Frohman who has a sort of monopoly In Great Britain the Harmsworths control a large number of newspapers and there is a distinct tendency towards the trust movement

† Hobson—*The Evolution of Modern Capitalism,* Chapter VIII

The Kartel does not directly control the management of the different businesses joining it, and it does not fix a uniform rate of profit for all these businesses, *it generally fixes only uniform selling price* for the commodity produced by the different business and it *also regulates their output* * With its looser organization, the Kartel is more easily formed and more easily dissolved—so the Kartel has less stability than the Trust

The Kartel system prevails largely in Germany, Austria, Belgium and other countries of the European Continent Some of the most powerful Kartels are to be found in the pig iron, steel and manufactured metal trades in Germany and Austria. The Westphalian Coal Kartel in Germany is the biggest and most influential in the world, and next to it and allied to it is the Steel Works Kartel

Only the future can show whether in Germany the loose and less stable organization of the Kartel will develop into and will be replaced by the more compact and stable organization of the Trust

(3) The *industrial pool* is an even looser form of industrial combination than the Kartel

Causes of Trusts.

The danger of fierce competition between powerful rival firms and the consequent loss of profits in many cases induce these firms to amalgamate themselves into a trust

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* *Export policy of Kartels*

To secure continuous employment for the several businesses joining the kartel, a carefully planned export policy is required The kartel regulates the output of the several businesses with the object of avoiding a volume of production which would be in excess of the need of the home market, but the tendency to over-production in modern industry is so powerful that the kartel has generally to allow relaxation as regards output for the foreign market and indeed it often organizes the export of the commodity at low prices to foreign markets even by payment of bounties The surplus output being thus disposed of at foreign markets, the kartel is able to maintain prices at home, and the sale of the commodity at low prices in foreign markets enables the kartels to cripple the competition of competing industries in foreign markets—in this way the rising infant industries of the foreign country if unprotected may be killed

Competition has become keener under the conditions of modern capitalism With the growth of large-scale production, rival firms engaged in the same industry grow larger in size, but they become smaller in number , and competition among them is intensified, prices are cut down, and the profits threatened The movement towards combination (and monopoly), towards the formation of trusts, kartels and pools has very generally resulted from the desire to escape from the effects of this competition So the causes which lead to the formation of a trust are (1) partly that large economies (industrial and also commercial) are expected from large capital and large-scale organization and management (11) but almost always a considerable monopoly revenue is expected from the regulation of output and prices and the abolition of competition

Economic supports of Trusts.

Mr Hobson mentions the following as the chief economic supports of trusts

(1) Superior access to raw materials (2) Superior control of means of transport and distribution

(3) Differential advantages in production or marketing due to patents, trade marks, special processes (4) Public franchises, licences or other privileges bestowing monopoly or restricting competition and (5) Tariff legislation

These supports are not mutually exclusive and two or more may exist together

The extent to which the protective tariff is really the mother of trusts is difficult to determine Mr Hobson maintains *"upon the whole it would be safer to describe the Tariff as the foster mother than the mother of Trusts"* for generally a tariff can create a Trust, only when the other conditions (*e g* , superior access to raw materials, to transport facilities, etc) are favourable Prof Taussig also holds a similar view

Advantages claimed on behalf of Trusts.

If we examine the history of the trust movement, we find that the trust problem is partly a problem of business organization and partly it is a problem of monopoly

(1) *Economies of production*

(1) The trust because of the immense scale on which it

produces can secure economies in connection with management, machinery, division of labour, raw materials which are beyond the powers of an ordinary corporation with a more limited scale of production The trust is also able to make a big saving in transportation relating to cross freights

(ii) With its stronger situation, a trust is in a position when necessary to borrow much larger funds for its business and on better terms than smaller concerns

(iii) The trust with its many factories is better able on account of its larger and more varied resources in plant, management, etc , to adjust production to demand than ordinary corporations , and *it secures steadier prices and stability of industry and trade and will do so in future (This advantage claimed on behalf of Trusts is allowed by some* and disputed by other economic writers)*

(II) *Economies of competition*

(i) There is the reduction of purely competitive expenses When there are competing businesses engaged in the same industry, they have to spend a great deal on *competitive* advertising, canvassers and travellers , when they are amalgamated into a Trust much of this expenditure is no longer wanted and is saved

(ii) A trust is also able to offer larger facilities (*e g* longer credit, etc) to traders than smaller businesses can afford to do, and in this way it pushes its sales

(iii) And with its larger resources in capital and managing ability, it can more easily capture and hold foreign markets than smaller rival firms

(III) The trust is better able to satisfy a great variety of taste among consumers by the immense variety of its stock of goods

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* Marshall in somewhat hesitating fashion (because the future of an economic tendency is always difficult of prediction) concludes "a *trust whose dominion is not threatened, generally promotes steadiness both of output and prices,* so far as it conveniently can For it is inclined to that policy by the magnitude of its investments, by the broad interests, which its chief proprietors commonly have in the stability of general business, and by that relative immobility which attaches to its gigantic organization "

So the trust has its advantages under proper conditions and with suitable safeguards, and it secures an immense increase in efficiency on industrial as well as commercial sides

In actual practice, however, the proper conditions and suitable safeguards are often wanting, and many serious evils are associated with the working of the Trusts in the United States where Trusts have attained a high degree of economic efficiency and development

Charges against Trusts.

The principal evils, associated with the Trust, are the following

I *Evils to the business community (through the use of unscrupulous methods, etc)*

A *Injuries to rival businesses*

(a) A Trust kills rival businesses by reducing prices in areas where there are competing independent businesses, and it compensates itself by raising prices after the rival business is killed

(b) Another charge brought against the trust is that a trust makes *unfair contracts with shopkeepers* allowing them to sell the products of the trust only on condition that the shopkeepers will not stock the commodity produced by other rival concerns

(c) The Trusts of the United States in various shapes often obtain *rate (i e freight rate) discrimination* from railroads, this is opposed to the law of the country and it unfairly handicaps independent businesses which try to compete with a Trust

B The Trust with its colossal strength makes it difficult for new men to enter the industry

C And it forces producers of raw materials to sell to it raw materials cheap

II *Evils to investors and shareholders*

It is also maintained with a great deal of truth that trusts are generally overcapitalized and suffer from the evils attaching

to *over-capitalization* and also gambling speculations by those in control Investors and shareholders are often and often grievously wronged

III *Evils to labourers*

The Trust with its substantial economies of production and monopoly profits can afford to pay high wages , and a few Trusts do use a small portion of their monopoly profits to raise wages, and thus to secure industrial peace with labourers and at the same time to conciliate the public

In some 'trusted' industries of the United States, whenever possible, trusts have used their monopoly position to lower the wages of unskilled labourers

As Mr Hobson points out, "the chief economy of the Trust will in fact arise from the net diminution in the employment of labour "

IV *Evils to consumers through high prices*

Systematic investigation into this question in the United States has proved that the trust maintains prices considerably above its expenses of production and never reduces its price to a point which will deprive it entirely of monopoly profit (In some cases a trust has reduced prices but this has been done generally for fear of competition or regulation by the State)

V *Evils to the state and to public morality*

Another grave charge against the trusts of the United States is that they with their vast resources are able to buy and do often buy legislators and judges to do their bidding and in this way they corrupt the political life of the State The interests of the public are sacrificed to promote the corrupt and selfish interests of the trusts

Conclusion.

The general conclusion among economists as regards trusts is briefly this

The trust-form of business organization has enormous economic advantages (because of the economies of large-scale

production relating to raw materials, transport, division of labour, machinery, marketing and finance) from the standpoint of the Trust itself, and also from the standpoint of society , and though in actual practice many grave evils are found in the working of the trust, some of them are remediable Therefore *trusts should be regulated by public opinion and by the Government so as to secure the benefits attaching to them while removing the evils as far as possible , trusts should not be absolutey crushed and repressed*

Huge accumulations of capital and immense development of machinery and markets, the dangers of fierce competition in these immense markets and the advantages of a monopoly, the psychology of the mass of the people which makes it impossible for them to manage most large-scale industries for themselves either through co-operation or Government management—these things make the monopoly inevitable in the United States, in Germany and to a smaller extent in Britain, and it is impossible to crush it altogether

Trust and other monopolies have flourished most in the United States of America, and the United States of America have taken the lead in systematic, long continued studies relating to the grave evils of these monopolies and in systematic, thorough-going attempts to regulate these monopolies partly by publicity and public opinion and partly by Government control , Germany and Britain are much behind the United States in these respects

Government Regulation of Monopolies (C. U. 1930).

Monopolies should be very carefully watched and controlled by the State to check their evils and *to secure as far as possible for the public the enormous economic advantages* of such organizations (The grave evils of monopolies and the important advantages associated with monopolic organizations are referred to in pages 321-325) Professor Taussig refers to the possible public advantages of monopolistic combination in the mitigation of industrial fluctuations Referring to American conditions he thinks that Federal Regulation of monopolies by the American government is called for as regards publicity,

capitalisation, eventually perhaps as regards profits and prices (Taussig's *Principles of Economics*, Vol II, Chap 65)

V. *Co-operation.

Large-scale joint-stock organization (sometimes amounting to a monopoly) and also individual entrepreneurs in manufactures, transport, banking, etc , have often oppressed (1) labourers by unfairly reducing wages , (2) small producers by unfair competition , (3) consumers by charging unfair prices , (4) borrowers by extorting unduly high rates of interest

Co-operation is the method adopted by these weak and oppressed labourers, small producers, consumers and borrowers to protect themselves and to remove grave economic and social evils , and the essence of co-operation is the joint effort of the weak originating among the weak and always conducted by the members themselves (this is democratic management) in more or less unselfish spirit for the benefit of the weak and suffering , and it is thus to be distinguished from ordinary joint-stock organization

Co-operation stands for democratic ownership and democratic management of business—while joint-stock organization

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*C B Fay in his *Co-operation at Home and Abroad* finally defines *the Co-operative Society as "an association* for the purposes of joint-trading, *originating among the weak and conducted always in an unselfish spirit*, on such terms that all who are prepared to assume the duties of membership share in its rewards in proportion to the degree in which they make use of their association "

He enumerates four principal types of co-operative effort—

I *Co-operative Banks* (usually called Credit Societies abroad) The co-operative credit society is the preliminary process of productive effort

II *Co-operative Agricultural Societies* The co-operative agricultural society is in most cases connected with the co-operative credit society, and it 'provides for its members a common channel either for the supply of materials to be made use of by them as individuals, or for the disposal of produce already individually raised '

III *Co-operative Workers' Societies* In these societies, the employees are their own employers

IV *Co-operative Stores*

I, II and III are Associations of Producers, IV only are Associations of Consumers

stands for democratic ownership (of shareholders) *but oligarchical management* by the directors of the business

During a large part of the 19th century, co-operation has been a main hope of reformers for removing some of the gravest economic and social evils of the world, almost providing a new heaven on earth , *though all these expectations have not been realised, yet co-operation has already worked marvels* and it may work yet greater wonders in the future with greater development of education, character and capacity for organization on the part of the people With favourable conditions, co-operation may yet prove a very big factor in the economic salvation of humanity

Co-operation is of different kinds, viz

(i) *Producers' co-operation* (or co-operative production)

(ii) *Consumers' co-operation* or co-operative purchase of commodities , this is sometimes also called distributive co-operation (or the co-operative store)

(iii) *Co-operative credit,* i e co-operative banking consisting of borrowing and lending

In this Book, we discuss only producers' co-operation , the other sorts of co-operation will be dealt with under appropriate headings in later books

Producers' Co-operation (Co-operative Production).

Next we take up co-operative production, co-operation as a form of business management

The essence of producers' co-operation is this—the labourers employed in a business become their own employers, they themselves undertake the risks of the business, or in other words, *the function of the labourers and the function of the entrepreneurs are united in the same persons*

The labourers, if they cannot raise sufficient capital from among themselves, will borrow the rest of the capital required They appoint their own foremen and managers, thus the employees of the business are employers of their managers and foremen

[The idea is to abolish the master class (the entrepreneur class) in industry There is to be no separate entrepreneur class *The labourers are to be their own masters, they are to have no other masters to obey So co-operative production is real democracy in business management, as the joint-stock company is oligarchical, and the single entrepreneur system is monarchical in organization* As in government so in industry, true democracy is difficult to establish, and difficult to maintain,—for the master class is still wanted, great leaders are rare and have their supreme uses, and as long as they are not unselfish enough, they generally will command their prices After all, in education and character, the world is not yet fully ripe for complete democracy, industrial or political, nor will it be perhaps in the very near future]

(A) Advantages of Co-operative Production.

The advantages of producers' co-operation are many and important —

1 *The labourers being themselves their own employers,* the business being their own business, *they work with greater care, energy and industry* than they would under any other system, and so they do not require much superintendence, the machinery is properly taken care of and there is no waste of materials, etc A considerable amount of expenditure is saved in this manner

2 It is also claimed in favour of the co-operative organization of production that by eliminating a distinct entrepreneur class separate from the labouring class, *co-operative production will do away with strikes*, and the labourers managing their own business will try to secure and will succeed in securing for themselves *more continuous employment and under better conditions*

3 The labourers who undertake the risks in this form of business organization are often good judges of business, so they find out quickly whether the general as well as the detailed management of the business by the managers are being done honestly as well as efficiently

It is clear that in many ways the co-operative form of business organization secures an increase in the efficiency of production

4 In the co-operative form of business organization, *the labourers get wages as labourers and as entrepreneurs they get profits in addition*

(B) Dangers and difficulties in connection with the business management of co-operative productive associations.

Producers' co-operation in actual practice has not proved successful in many cases

This want of success is mainly due to the following facts —

1 The control of the employer-employees (labourers who are also employers) over the managers, is in one way a great source of weakness—*the labourers often interfere too much with their managers and without proper knowledge and discretion The result is inefficiency* "Multitudinous management means relatively uncertain, indecisive and inefficient management"

The employer-employees of a co-operative organization are often too impatient of criticism and rebuke by their foreman, and so there is a loss of efficiency

2 *Co-operative businesses do not get generally the best managers for they do not pay sufficiently attractive salaries* The employer-employees of a co-operative business working mostly with their hands are generally apt to underrate the value of head-work (*i e* hard intellectual work requiring the exercise of high intellectual powers), and so they will not pay high salaries to managers for the work of management and they will get only inferior grades of managers

In these ways co-operative associations tend to be less efficiently organised than other sorts of business

Conclusion.

Though producers' co-operation has as yet succeeded only in a limited number of cases on account of the difficulties out-

lined above, it has a great future before it The difficulties are being and will be gradually surmounted

With the increasing diffusion of the co-operative movement, a larger and larger body of men is being found with adequate capacity for business management and yet willing to serve honestly and faithfully co-operative businesses for the sake of their devotion to the co-operative principle and on a remuneration lower than what they would accept in other businesses This is a hopeful sign , this coupled with the growing enlightenment of workmen in business matters and their expanding capacity for combined action seems to indicate a promising and highly useful future for producers' co-operation

We have also producers' co-operation among small producers like village weavers, or others engaged in cottage industries and handicrafts , and there is a great future for this kind of co-operative production specially in India

Profit-sharing.

More limited applications of the co-operative principle are also found in productive organizations One of these is profit-sharing *Under the system of profit-sharing, the labourers get wages at the market rate and in addition they get a share of the profits* if the profits exceed a certain minimum rate

Advantages and disadvantages of profit-sharing (See Distribution)

For (ii) **Consumers' Co-operition,** and (iii) **Co-operative Credit,** refer to Part II Book V, chapter iv

IV. Government undertakings (i.e. government management of business).

The businesses managed by a government are generally lacking in the free initiative which is the basis of progress, industrial and otherwise Government businesses are generally less plastic and less efficient than private businesses

A business owned and managed by a Government is directed by Government officials who are more or less steeped in routine—and who have not the same inducements to energetic

and efficient work as exist under the system of private enterprise For in private enterprises (*i e* private partnerships or joint-stock companies, etc), officers and men have their promotions and prospects closely dependent on their business efficiency and capacity to earn profit for the business , but in a business owned and managed by the government, the government officials have their promotions and prospects dependent on seniority rather than on business efficiency *The result is that a government undertaking is inferior in efficiency in most cases to a private business*—except in countries (like Germany) where government officials have a high standard of duty and are properly versed in business matters

In Britain and in the United States, Government management of business is regarded as less efficient than private management in the case of most industries

In India, Government mangement is not so much inferior to private management as in England and the United States Moreover Government enterprise was wanted in India in railways for military reasons in the interest of the British occupation and in railways and irrigation to supplement the deficiency of private enterprise , and the scope for Government undertakings in India is still large

The War and after.

The last World War immensely rich in new experiences, promises important developments in connection with Government undertakings During the war, in all belligerent countries vast enterprises were started for the manufacture of munitions and other things—some under Government management, and others under Government control and with Government support Existing industries, factories, workshops, railways, ports and dock-yards, imports and exports were also under Government control for war purposes Some of these experiments succeeded, not a few failed , but very valuable experience has been gained One thing is however sure—a considerable extension of Government activities in future based upon and made possible by these war experiences

Though in many countries government management is generally less efficient than private management in many industries, *yet government management is suitable for some industries and is necessary in the public interest*, and government management in some other industries has been proved by the last World War to be necessary under certain conditions

Under present conditions of public opinion and the present constitution of Government in Britain, France or the United States, *Government management by central or by local authorities* (municipalities, etc) *is suitable for industries making things that sell themselves,* as they are in large demand and are standardised more or less, *and specially where many routine operations* are performed under the public eye* or for the service of individuals, who will immediately detect and expose any failure or laxity *Examples of such industries suitable for Government management are the postal system, the telegraph system, railways* (under certain conditions) in a country, the *supply of water, power, light in towns, etc* These industries supply commodities and services which are in large demand,—and the demand being not greatly fluctuating or changeable, such industries are capable of being managed by the routine methods of Government departments (2) *Also as shown by the experiences of the last World War,* in case of urgent need only *the Government should itself undertake the manufacture of such articles as may be essential for national safety* (3) And the Government has also duties in connection with *'key' industries* (*e g* industries connected with certain important drugs, optical and chemical glass, certain gauges, tungsten, magnetos, etc) and where necessary it should give financial and other assistance to pioneer firms engaged in these key industries (*Also refer to Part II , Book VI, Chapter II of this book*)

† An increase in the number of industries under government management means an increase in the numbers of the

* Jevons—*Methods of Social Reform*

† *"But it seems to remain almost as true now, as in former times,* that the heavy hand of Government tends to slacken progress in what-

bureaucracy—and with this we should have an increase in the capacity of the National Parliament to control the bureaucracy and also an increase in the capacity of the people to control their Parliament, otherwise democracy will be a failure and politics and industry will be poisoned at the source

[*Socialists are for greatly extending the government management of industries,* they are for making the government take charge of all the industries of the country for the purpose of management, but in Europe (excepting Russia) and America, public opinion is not yet ripe for such a revolutionary change —Russia is the only country that has adopted socialism in practice **(For Socialism, refer to Book VI, Chap. II.)**

Industrial Organization in England and India.

The economic transition in India from the older industrial organisation to the new—characteristics of the old system and of the new system.

An account has been given in Book III, Chapters VI-IX of the modern industrial organization (of European origin)—industrial organization as it exists to-day in England, France, Germany and the United States In India the situation is somewhat different *India is passing through an industrial revolution—she is now in a stage of economic transition** (England, France, Germany and the United States have already passed through this stage) from the older type to the modern form of industrial organization

In the older type, each village is more or less a self-contained economic unit, in the modern system the whole country is economically inter-dependent and each village is no longer self-sufficing, in the older type, industry is necessarily on a small scale, the markets are small, division of labour is small, and localization of industry imperfectly developed,—in

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ever matter it touches, and finally that "business influences are apt to corrupt politics, and political influences are apt to corrupt business" Marshall—*Industry and Trade* (Appendix P)

* Morison—*The Economic Transition in India*

the modern system, industry is on a larger scale, the markets wide, sometimes world-wide, there is machine production, great extension of division of labour and of the localization of industry , and the complexity of modern industry gives rise to a class of business specialists, the enterprisers , custom for good and for evil has great influence on the older system, in the modern industrial organization wide and increasing economic freedom is the rule

This industrial revolution in India is being brought about by the impact of western industrial ideals and civilisation and the importation of machinery and machine-made goods (helped by the rapid development of railways and other forms of transport in India) , *and it is as yet far from complete*

(1) *Agriculture*

Agriculture in India has been but little affected , it is still very largely (almost wholly) under the older organization—it is primitive, unscientific and much less efficient and productive than agriculture in modern Britain, France, Japan and the United States Each farmer cultivates his small holding in the old way generally with his own labour, with insufficient capital and credit, and an insufficient knowledge of markets—he is labourer, and the enterpriser For he generally works on his own account and serves no master (Of course in every Indian village, in addition to these independent farmers, there are also landless labourers)

But there has been an important change in Indian agriculture in another direction—"**We find an increasing degree of local specialisation in particular crops, especially in those grown for export* Cotton is now no longer planted in small patches in almost every village where conditions are not absolutely prohibitive, but is concentrated in areas which are specially adapted to its various types The peculiarly favourable climate of Bengal has tempted the ryots to extend their jute cultivation often at the expense of their food stuffs The

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* Report of the Indian Industrial Commission

people have been led to make this change by the cheap railway and steamer transport and by the construction of roads, which, while facilitating foreign imports

"Improved means of communications (*i.e* railways, etc) have had another important effect in altering the nature of famines and in lessening their disastrous results it is now possible, thanks to railways, to direct supplies (of food) from the export trade to the famine-stricken tracts Famine now connotes not so much a scarcity or entire absence of food (as in pre-railway days) as high prices and a lack of employment in the affected areas "

(2) *Industries—manufacturing, mining, etc*

Many old handicrafts (handloom weaving is the most important of them) *and important art industries have perished or are in a dying condition or are struggling for life* against modern machine-made goods Even according to the extreme Free Trade doctrine, many such industries require help during the transition period, and this help they did not and do not get Millions of unemployed workers in these industries have been driven to the land, or have become unskilled labourers , and there has been an immense, an incalculable loss to the nation in productive capacity and skill The loss has not always been made up by the establishment of corresponding industries of the modern type One or two old industries have been modernised , and *some new industries of the modern type have been started, e g* in jute and cotton manufactures, in woollen, leather and sugar factories, in mining and in transport (railways, etc) —but these have been *chiefly with European capital and management* and the profits go out of the country

Many old industries with valuable moral, social and artistic features have been destroyed—and some (possibly many) could have been saved with informed enthusiasm on the part of the Indian people, and helpful sympathy on the part of the Indian Government *New industries have not always taken their places* , and the country as a whole, is yet a good distance off from being fully equipped with the modern industrial organization With 150 years of British connection, India is a great deal more backward in assimilating useful and progressive

elements of western industrial civilization than Japan with fifty years' experience In part this is due to the poverty, lethargy and the conservatism of the Indian people but it is also due to British trade jealousy and the inactivity of the British Government in matters of Indian commercial and industrial development

The situation as between England and India.

England is now mainly a manufacturing country, India at present is largely agricultural , a manufacturing country, England chiefly exports manufactures and imports chiefly food stuffs and raw materials for her industries, India with her agricultural conditions exports largely agricultural products, food stuffs and raw materials, and imports largely manufactures of different kinds , England with her immense wealth (from manufactures and commerce) is a creditor nation, she lends ; India is a debtor nation, she borrows

Different views on the Indian Industrial Revolution.

The progress of the Industrial Revolution now in India (as in an earlier period in England and other countries of Europe) is being attended with serious evils mostly of a temporary character—capitalist exploitation of labour, overwork and insanitary conditions in factories, employment of women and children for excessive hours and under improper conditions, overcrowding in the slums of industrial towns amidst unhealthy conditions, physical and moral In Europe, these evils have been removed in some measure by trade unions of the labourers themselves, by housing and town-planning experiments, and by Factory Acts and other forms of labour legislation by the State These remedies will be also required in India, and indeed some of them have been already partly introduced

(1) *The extreme advocates* (Mahatma Gandhi, Dr Coomarswamy and others) *of the old system* point to these evils of the Industrial Revolution and the evils of machinery and of the modern industrial organization and are wholly for retaining the old system and rejecting the new , (2) *the extreme advocates*

of the new system (consisting chiefly of British and Indian large-scale manufacturers, mine-owners, etc) more or less ignore these evils and are for wholly rejecting the old system and accepting the new , (3) *the middle view is a compromise between the two* —it accepts the new system for its high productive efficiency, but recognises its temporary and other evils and tries to secure the advantages of the new system and to remedy its evils , and it also tries to preserve and develop the old handicraft and cottage industries as far as possible under present economic and social conditions

A question for the future.

So a question of profound and far-reaching importance is this Whether India should reject altogether the new system , or whether India should discard wholly the old system, and replace it entirely by the newer organization of the West , or in the alternative whether India should gradually adapt herself to the new conditions and the new system while maintaining within proper limits her old small-scale industries and handicrafts, and making full and effective use of her rich communal instincts and valuable communal institutions, the precious inheritance and possession of long centuries Is everything to be new, or are we to build the new structure on the old and well-tried foundations?

CHAPTER X

BUSINESS MANAGEMENT.

Summary.

1 In industrial organization, business management is the all—important factor

2. Types of Business Organization.

The principal types of business organization are (1) the single entrepreneur system—one-man-management (11) the partnership-manage-

ment by two or more partners, (iii) the corporation or joint-stock company, (iv) monopolies, (v) co-operative management, and (vi) government management

3. The Entrepreneur.

(*a*) The entrepreneur is the man who controls a business, who organizes it and undertakes the risks of profit or loss (The salaried manager is not an entrepreneur because he is not a risk-taker—the risks are not his but of his employer)

(*b*) The rise of the modern entrepreneur class is due to the increased magnitude and complexity of modern business

(*c*) The principal functions of an entrepreneur are—

(1) organizing—organization of the factors land, labour and capital in the work of production

(2) risk-taking—taking the chance of profit or loss, getting a profit if the business succeeds and getting nothing or even losing if the business is a failure

The entrepreneur is the captain of industry, he is the master who rules industry and upon him everything depends

(*d*) The ideal entrepreneur must have knowledge of *men* and also of *things*—he must be a born leader of men, and he must have a general knowledge of things in his own trade

Entrepreneurs in the actual business world, most of them, do not come up to this ideal standard

(i) *The single entrepreneur system*

1 The single entrepreneur system has its advantages, also its disadvantages It still dominates the field in agriculture and retail trade

(ii) *The partnership*

Partnerships have certain advantages over the single entrepreneur system They possess elements of strength and flexibility, but they have one great and serious disadvantage—unlimited liability

(iii) *The Corporation (Joint-stock Company)*

Within recent times, the corporation (or Joint-stock Company) with its limited liability has superseded in large measure the single entrepreneur and the partnership forms of business organization

Advantages enjoyed by the Joint-stock Company

The corporation (with its limited liability, its transferable shares, its organization of directors, managers, and shareholders), has large and substantial advantages—the limited liability diminishes the risks of the shareholders, small and easily transferable shares make it possible for all classes of people to invest and encourage saving, also stability, and within limits efficiency and flexibility of management are secured

Disadvantages

In the joint-stock form, limited liability sometimes leads to rash enterprises, the transferability of shares weakens the sense of mutual

support, the organization divides responsibility and increases the risk of mismanagement

The joint-stock form has increased the distance between the employers and the employees, and it has sometimes led to gross corruption and dangerous disregard of public welfare /

Proper field for the joint-stock system

The Joint-stock Company is specially suitable for large-scale enterprises, and enterprises in which the management is of a routine character, also for risky undertakings

The Joint-stock Company now dominates the field in railways, and other forms of transport, in banking, insurance, many large manufactures, also in mining

The financier

The financier is the middleman between the investor and the entrepreneur His large and increasing control over the modern industrial organization is under present conditions a serious danger and menace to society

(iv) *Monopolies*

Monopoly means absence of competition—the larger the measure in which competition is absent, the more complete is the monopoly The chief essential in a monopoly is exclusive control and specially as regards the price of the monopolised commodity

Monopolies have been classified as (1) natural, (2) social, (3) legal, (4) and voluntary monopolies Another classification is into (1) local, (2) national (3) and international monopolies

Some forms of monopolies are (*a*) the Trust with its complete unity of organization, (*b*) the Kartel which is more loosely organized than the Trust, (*c*) the industrial pool, and even looser forms of industrial combination, viz, alliances, etc

The Trust

Causes—The causes which lead to the formation of Trusts (and other monopolies) are (1) partly the economies expected from large capital, large-scale organization and management, (2) partly the desire to secure a monopoly revenue

Advantages

A Trust has (1) large economies of production—in connection with management, machinery, division of labour, raw materials freights, and adjustment of production to demand

(2) also economies of competition (compared with small firms)—through lowering advertising and canvassing expenses, better terms offered to shop-keepers, and also in foreign markets

Charges against Trusts The principal charges against Trusts are these—they unfairly injure rival businesses (by unfair rate discrimination and unfair arrangements with shop-keepers, etc), they injure pro-

ducers of raw materials, they injure investors and shareholders through frequent over-capitalization, they injure consumers by the high prices, they often injure labourers by depressing wages and reducing employment, they make it difficult for new men to enter business, and they corrupt public morality and seriously endanger the public welfare

Trusts should be regulated and not repressed, their good points preserved, and the undesirable features eliminated by suitable government regulations and a developed and informed public opinion

(v) *Co-operation*

Co-operation in its most comprehensive sense includes both voluntary and compulsory co-operation (*i e* socialism)

Voluntary co-operation has many forms—(*a*) producers' co-operation, (*b*) consumers' co-operation, (*c*) co-operative credit, etc

Producers' Co-operation

Democracy in business management is found in producers' co-operation Here the labourers are their own masters and entrepreneurs—and the object is to eliminate a separate entrepreneur class

(*a*) *Advantages*

The business being their own business, the labourers work with greater care, energy and industry, there is less need for supervision, less friction, there are fewer strikes, more continuous employment is secured for labour and under improved conditions So in some respects there is a gain in efficiency

Labourers gain because they get wages, and in addition they get the whole profit

(*b*) *Disadvantages and difficulties*

In co-operative production, labourers are their own masters, but generally they are not efficient masters That is the difficulty

Their multitudinous control over the business is often weak and hesitating, they quarrel with their own foremen and are impatient of discipline, and they generally do not get the best managers for they are unwilling to pay large salaries

In *profit-sharing*, a partial application of the co-operative principle is to be found

(vi) *Government business*

Another form of business management is the government undertaking —in this the management is by the government and not by private business men

Generally speaking, government businesses are less efficient, more rigid, more mechanical and routine-bound than private businesses Indeed this is what we find in England, France and the United States

Government businesses in railways and other fields have been successful in Germany, also in India where private enterprise is deficient and the scope of government undertakings is large

The war led to a great extension of government undertakings Important developments are also expected in future

Questions.

1 Name the more important types of business organization as found in the modern industrial world Do you notice any connection and correspondence between political and economic institutions as regards questions of management and organization? Give reasons

2 Account for the rise of the modern entrepreneur class

Describe briefly the functions of the entrepreneur and the important services rendered by skilful business management (C U 1909, 1912, A U 1908)

What are the qualities which go to make the ideal entrepreneur?

What is the importance of business ability as a factor of production? How can it be increased? (C U 1919)

3 (*a*) Define a Joint-stock Company

Give in brief its characteristic features, economic and also legal

(*b*) What are the advantages and disadvantages of the Joint-stock form of business organization? In what respects is it superior to the partnership form?

In what industries and under what conditions is the joint-stock organization successful and why?

Give some reasons for the great increase in the number of joint-stock companies in recent years (A U 1905, 1909)

(*c*) Write a note on Indian Joint-stock Companies, their present position and difficulties and their prospects in future

4 (*a*) Define a monopoly

(*b*) Describe the different classes of monopolies

(*c*) What are Trusts and Kartels? What are the advantages of Trusts and what are the evils associated with them?

Discuss the economic effects of the growth of combinations in industries (C U 1922)

5 Carefully contrast joint-stock companies and co-operative associations

Write a note on co-operative production, indicating the elements of strength in it and also elements of weakness

6 Explain and examine the following propositions

(*a*) The entrepreneur sells finished products and buys factors of production

(*b*) "The industry of the world is tending not towards democracy but in the opposite direction" (Walker)

(*c*) "The joint-stock company is in most instances, a close oligarchy, the monetary support of the public is wanted, not their direction" (Hobson)

(*d*) "The essential difficulty in the way of co-operation in production is that it attempts to supersede the business man where he is most needed" (Taussig)

7 Write notes on—

(*a*) Over-capitalization, (*b*) and the financier class

CHAPTER X

LAWS OF RETURN.

Laws about the co-operation of factors of production.

The production of wealth is brought about by land and labour (the primary factors of production), and capital (a secondary factor which is the product of land and labour) and also organization There are three Laws which govern the co-operation of these factors—the Law of Increasing Return, the Law of Diminishing Return, and the Law of Constant Return

Increasing, Diminishing and Constant Returns.

The expressions increasing returns, diminishing returns and constant returns as applied to an industry mean the following things—

1 When an increase of capital and labour applied to an industry and enlarging its size is followed by less than proportionate increase of product, (*i e* when the marginal returns of representative firms or typical businesses fall or diminish) then it is said that we have diminishing returns in that industry

2 When an increase of capital and labour applied to an industry and enlarging its size is followed by a more than proportionate increase of product (*i e* when the marginal returns of typical businesses in the industry increase)—then it is said that we have increasing returns in the industry

3 And when an increase of capital and labour invested in an industry is followed by a proportionate increase of product (*i e* when the marginal returns of typical businesses remain

constant and do not increase or diminish) then it is said there are constant returns

***Representative Firm.**

A representative firm in a particular industry is one "which has had a fairly long life and fair success, which is managed with normal ability and which has normal access to the economies external and internal which belong to the aggregate volume of production," it is a firm which is not exceptionally successful and is not also exceptionally unsuccessful, its efficiency is not above the average nor below it

So the representative firm is a typical firm We have representative (or typical) firms in the cotton industry of Bombay, in the jute industry of Bengal, in tea gardens and coffee plantations and other well-established industries

Some Bombay cotton mills may be exceptionally successful and may earn 40 to 80 p c and some may be exceptionally unsuccessful But the typical firms in the cotton industry may be those established for about 10 years, and earning an annual profit 10 to 20 p c

Internal and External Economies.

The economies arising from an increase in the scale of production of any kind of goods are divided into two classes—

(1) *External economies* *These are economies due to the general development of the industry* and not to the organization and resources of any particular firm engaged in the industry, *e g* when an industry is localized in a particular locality many external economies are realized by the different firms engaged in the industry through the development of subsidiary trades, (which supply cheaply the tools, materials and sometimes the machinery for the industry), the improvement of transport facilities and in other ways

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* The conception of the representative firm has been introduced by Prof Marshall, and though much criticised it has its uses in Marshall's study of supply and value

(11) *Internal economies Economies dependent upon the organization and resources of a particular firm* engaged in the industry are called the internal economies of that firm as distinguished from the external economies which are enjoyed by all the firms belonging to that industry Internal economies may be due to a better division of labour, greater specialization of machinery, more economical use of power and other things

[A firm which is managed by an entrepreneur of exceptional ability will have more internal economies than a firm managed by an enterpriser of inferior quality]

I. The Law of Increasing Return.

As regards many industries, it is found that an increase in the total volume of production of the commodity produced by that industry increases the size and the internal economies possessed by the representative firm in the industry and also its external economies Consequently, the representative firm by increasing the investment of capital and labour will be able to get a more than proportionate increase of product—it will have increasing returns

Marshall on the Law of Increasing Return

Prof Marshall thus enunciates the Law of Increasing Return—an increase of capital and labour leads generally to an improved organization which increases the efficiency of the work of capital and labour

Marshall remarks "We say broadly that while the part which Nature plays in production conforms to the Law of Diminishing Return, the part which man plays conforms to the Law of Increasing Return" He implies that in industries engaged in producing raw produce (agricultural products like cotton, jute, also minerals, etc), we have generally diminishing returns because of the preponderant part played by Nature in these industries, and that generally we have increasing returns in manufacturing and other industries where man and not Nature plays the preponderant part

Industries subject to Increasing Returns. Causes.

The tendency to increasing returns is found in manufacturing and very strongly in transport industries (*e g* railways, etc) , also sometimes it is found in mining, and but rarely in agriculture

Now increasing returns may be due to internal economies, or external economies or both

In certain industries, with an increase of capital and labour there is more scope for division of labour, for specialized machinery, and other internal economies , also there may be increasing external economies in connection with transportation and other sides of the business

Internal economies and monopoly

If the internal economies of a business go on increasing with every increase in its size, the result is often a monopoly As the firm grows bigger, with its increasing internal economies it becomes more and more efficient . and it successfully undersells its competitors till it brings about the establishment of a monopoly Internal economies do not always increase, and so monopolies are not always formed

The Law of Increasing Return in a more general form.

The Law of Increasing Return in its more general form (as applied to all agents of production) is this

At any given time and under given conditions, the increasing application of other agents of production upon an agent will be followed by increasing returns (*i e* , returns more than proportionate to the increase in the amounts of these agents), if additional supply of the agent upon which the other agents are applied is available when required for the work of production

The law is stated thus by Prof Chapman "The expansion of an industry *provided there is no dearth of suitable agents* in production tends to be accompanied, other things being equal, by increasing returns "

The Law of Increasing Return in History.

The study of the history of human progress and civilization tells us that increasing returns are obtained from manufacture over long periods of time apart from the enlargement of the market, and that

over long periods of time the tendencies to decreasing returns as regards production of raw produce are likely to be largely neutralised

This is due to the progress of human knowledge, new inventions relating to productive processes and machinery, methods of organization and so on

**Abstract and realistic statements of the Laws of Return*

Prof Chapman calls the general statements of the Law of Increasing Return and the Law of Diminishing Return as statements expressed *abstractly*, and he remarks that the Law of Increasing Return as understood more *realistically* is taken to assert that increase of capital and labour in manufactures leads generally to increasing returns and that the Law of Decreasing Returns as understood more *realistically* is taken to assert that increased efforts to obtain natural products lead to decreasing returns—in case of manufactures there being no dearth of suitable agents in actual practice, and in the other case there being generally a dearth of supply of natural agents

Prof Chapman also distinguishes between (1) the non-evolutionary laws of return which include the abstract and the realistic statements of these laws and (2) the evolutionary laws of return which express the course of returns to agents of production as found in the history of human progress and civilization

II. The Law of Diminishing Return.

The Law of Diminishing Return in its application to agricultural production and also to river fisheries, mining, etc has been already stated in Book III, Chapter II

It has been seen how at any given time there is a point (the point of diminishing returns) in the investment of labour and capital upon *natural agents* beyond which further investment of labour and capital produces only a less than proportionate return of products

The law of diminishing return has been also stated in that chapter in a very general form to apply *not only to natural agents but also to other agents of production*

III. The Law of Constant Return.

If at any given time and under given conditions, increasing applications of labour and capital in an industry produce returns exactly proportionate to the increase of capital and

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* Chapman—*Outlines of Political Economy*, Book III, Chapter XI

labour, then we have the operation of the law of Constant Return

In a country where the blanket trade is but slightly developed, an increase in the total volume of production of blankets may lead to such great economies in the manufacturing process, may bring about the operation of increasing returns so strongly that the increasing returns from the work of manufacture may be able to counter-balance the operation of diminishing returns as regards the production of the raw material, *viz* wool

Similarly there may be constant returns in other industries where the operation of decreasing returns regarding raw material is exactly neutralised by the operation of increasing returns as regards the manufacturing of that raw material

Also refer to pages 160-161—**Professor Edwin Cannan on the Laws of Return.**

CHAPTER X

LAWS OF RETURN.

Summary.

1 There are three laws relating to the co-operation of factors of production—(1) Law of Increasing Return (2) Law of Diminishing Return (3) Law of Constant Return

2 *A representative firm is a typical firm*

3 (*a*) In certain manufacturing and other industries, with an increase of capital and labour, the internal and external economies of the representative firm increase, and there is a more than proportionate increase of product—we have the operation of the Law of Increasing Return

(*b*) In industries like agriculture, mining, etc , with an increase of capital and labour, there is, *in general,* a less than proportionate increase of product—we have the operation of the Law of Diminishing Return

As Marshall says "the part which Nature plays in production conforms to the Law of Diminishing Return, the part which man plays conforms to the Law of Increasing Return "

(*c*) Also it is possible that in certain cases with an increase of capital and labour, there is a proportionate increase of product neither more, nor less—and then we have the operation of the Law of Constant Return

Questions.

1 What is a Representative Firm? Give Indian examples Distinguish between internal and external economies

2 Explain the Law of Increasing Return and the Law of Diminishing Return and show the relation of the one to the other in production (C U 1894, 1897)

Elucidate the statement "while the part which Nature plays in production conforms to the Law of Diminishing Return, the part which man plays conforms to the Law of Increasing Return "—Marshall

3 State and explain the Law of Constant Return Illustrate by examples

4 Explain carefully the Laws of Increasing, Constant and Diminishing Returns (C U 1922)

BOOK IV.

VALUE AND EXCHANGE.

CHAPTER I

Exchange as a department of Political Economy.

The division of Political Economy into Production, Distribution, Exchange (Interchange) and Consumption, is first found in England in James Mill's Elements of Political Economy *

Early English economic writers (*e g* James Mill and also John Stuart Mill, etc) generally treat of Exchange after finishing the department of Distribution

In modern economic societies, distribution of wealth in the shape of rent, wages, interest and profit takes place through exchange , and so recent writers (like Walker, Ely, Taussig etc) treat of Exchange before Distribution Professor Marshall treats of Distribution through Exchange in Book V (entitled Value or Distribution and Exchange) of his *Principles* Treating Distribution as a process of valuation through exchange of the services of land, labour, capital and organization, he has given a degree of unity to the science which it formerly did not possess

Is Exchange a separate department of Political Economy ?

(Some writers have objected to Exchange being considered as a separate department of Economics They hold that exchange is only a form of production, that persons engaged in commerce, employed in packing goods or transporting them to the market are as much engaged in the production of wealth as persons employed in agriculture or manufactures. Therefore Exchange should not be made a separate department of Economics, but should be included under the department of Production)

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* Cannan—*Theories of Production and Distribution*, Chapter II

Walker points out that the view of these writers is due to a confusion of Exchange with trade or commerce, and he thinks that the subject of the Ratios of Exchange (the terms on which goods possessing value exchange for one another) is best treated apart from the subject of the production of wealth

The Advantages of Exchange.

Exchange utilizes fully the existing wealth and productive capacities of individuals and nations, and the progressive development of exchange helps to bring about the development of productive powers

(1) Exchange makes it possible for *wealth*, which would otherwise remain unutilized to be utilized to the greatest advantage, without exchange with foreign countries England would be unable to utilize fully her resources in coal, California her gold, India her jute and Australia her wool

(2) Exchange enables the *productive capacities* of individuals and nations (which without it would remain comparatively inactive) to be used to the best advantage

If exchange did not exist, each man would have to produce his own necessaries, he would have to produce according to his *wants* and not according to his *aptitudes* Under the system of exchange, each man produces according to his *aptitudes* (*i e* he produces what he is best fitted to produce) and not according to his *wants*, and he gets the things which he wants in exchange for the things which he has produced This production according to aptitudes utilizes productive capacities of individuals more fully than would be otherwise possible

Exchange also uses productive capacities of different nations to the best advantage by making it possible for each nation to devote itself to the industries for which it has got special aptitudes, and the nation gets other commodities from other nations in exchange for the products of its own industries

(3) The progress of exchange leads to progress in production As exchange develops markets become larger, the scal of production increases and with it division of labour i

extended and there are improvements in machinery and methods of organization

The organs and instruments of exchange.

The following are the indispensable organs and instruments of exchange without which exchange would be almost impossible, and improvements relating to these will facilitate the work of exchange and increase its efficiency

(1) *Merchants or traders* who serve to bring producers and consumers together

(2) *Means of transport* (*e g* good roads, navigable river channels, railways, ocean transport etc) which enable goods to be transferred from one place to another for the purpose of exchange

(3) *Markets* where the exchanging is done and things are bought and sold

(4) *Money* which is the medium of exchange (and which makes it possible to dispense with barter)

Merchants and means of transport do not require any special treatment particularly in an elementary work like this *We now proceed to discuss in detail markets where the exchanging is done and then money which is the medium of exchange*

CHAPTER II

EXCHANGE. MARKETS.

Equilibrium of Demand and Supply.

Increasing importance of Markets and Exchange.

In a complete subsistence economy where each family produces all things it consumes, there is no exchange and there is no market—to find such an economic society we have perhaps to go to the beginnings of history, to the Stone Age Exchange and Markets appear however at a very early stage in the evolution of society—they are to be found more or less even among

very primitive peoples , and with the progress of social evolution, and with the growing division of labour, the exchanging function and markets have become more and more developed and important

In India at present general economic development is much less than in Europe and America, and so also the development of exchange and markets

Economic Markets.

Definition of an Economic Market.

An economic market is a group of exchangers competing,—it refers to a number of buyers and sellers of a commodity brought into direct competition with one another for the purpose of exchange So to constitute an economic market, two things are essential—(1) *a group of buyers and sellers,* (2) *competition between them*

A single competitive price is the essential feature and test of a market

Where a complete market organization exists, there can be but one price at any particular time for the same commodity throughout the market

The more perfectly organized the market is, the fuller and freer is the competition, the greater is the tendency for the same price to be paid for the same thing at the same time in all parts of the market

(We must however make allowance for the cost of transporting the commodity from one part of the market to another, the price of the commodity in one part of the market is often greater than in another part on account of this transportation charge)

Some Definitions of Economic Markets.

Some definitions of the economic market by distinguished economic writers are of interest in this connection

(1) *Hobson*

* *Market is the name given to a number of directly competing businesses*

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* Hobson—*Evolution of Modern Capitalism*

(2) *Walker*

* Walker says "the term market in Political Economy should have reference first to a species of commodity, secondly to a group of exchangers *there are as many markets as there are groups of exchangers*"

(3) *Cournot*

Cournot says "Economists understand by the term market *not any particular place* in which things are bought and sold *but the whole of any region in which buyers and sellers are in such free intercourse* with one another that the prices of the same goods tend to equality easily and quickly"

(4) *Chapman*

Prof Chapman's definition is this ("*Economically interpreted, the term 'market' refers not to a place but a commodity or commodities and buyers and sellers of the same who are in direct competition with one another*")

(5) *Jevons*

Jevons says "Originally a *market* was a public place in a town where provisions and other objects were exposed for sale but *the word has been generalised to mean any body of persons who are in intimate business relations and carry on extensive transaction in any commodity*"

The central point of a market is the public exchange, mart or auction rooms where the traders agree to meet and transact business In London the Corn Market, the Stock Market, the Coal Market, the Sugar Market and many others are distinctly localised *But this distinction of locality is not necessary,* the traders may be spread over a whole town or region of country and yet make a market if they are by means of fairs, meetings, published price-lists, the post office or otherwise in close communication with each other" (*Theory of Political Economy*)

"A market consists of a great many holders of a certain kind of commodity, and of many who desire to hold or use the same, and are more or less perfectly acquainted with the holders and other demanders" (*The Principles of Economics*)

Evolution of Markets.

The modern economic market has developed only by gradual stages Prof Nicholson (*Political Economy,* Vol II) describes the development of markets relating to (*a*) publicity, (*b*) freedom of trade, (*c*)

* Walker—*Political Economy*

competition prices, (*d*) limits of time and place, and (*e*) restraint of speculation

The various stages in the evolution of markets are thus given by Prof Chapman (*Outlines of Political Economy*, Chapter XII)—

1 The localization of markets
2 Dealing by sample
3 Dealing by grade
4 Differentiation of markets

1 Localization of markets

Without the localization of markets, buyers and sellers have to spend a good deal of time in moving about and trying to meet one another, this time is saved by localization The localized market has generally a market-place Competition becomes keener with the localization of markets, and so in the localized market one price at one time for one commodity is likely to be the rule The area of the localized market depends upon the transportation facilities

2 Selling by sample

This is another stage in the evolution of markets Where the system of selling by sample does not exist, bulky goods have to be carried to the markets to be displayed and this is very inconvenient The market in which samples are substituted for the actual goods to be sold, draws on a wider area of supply, and competition within it becomes keener and more effective

Obviously all goods cannot be sold by samples Wheat can be sold by sample, because samples of wheat taken at random from the produce of land of the same quality sown with the same seed will be of the same quality as the rest of the wheat produced from the same land, and so also rice and many other grains, cotton, jute and other natural products, etc

3 Selling by grade

Selling by grade is another step in the development of certain markets For the purpose of selling by grade, the commodity is divided into several grades (classes) each differing in certain points from other grades, and each grade has its own name or mark

And when grading has been done, a buyer can purchase a commodity even without seeing samples by simply indicating the name or the mark of the grade which he requires

The introduction of dealing by grade still further expands the area of the market and makes the market more perfect by making competition keener within it

4 Differentiation of markets

At first the market was a mixed market in which different commodities were bought and sold The market grows in size with the development of transportation facilities and it gradually begins to differentiate into different markets for the different commodities—the fruit market for fruits, the vegetable market for vegetables, the market for textiles and so on

The process of differentiation is given a great impetus by the system of selling by samples and grades

The Economic Market and the Market of ordinary speech distinguished.

After these definitions of the economic market, it is now easy to understand the difference between (1) the economic market, and (2) the market of ordinary speech as ordinary people understand it (*The market of ordinary speech* (*e g* the College Street Market in Calcutta) *refers to a particular market-place* (*a locality*) where buyers and sellers meet and many kinds of things (rice, wheat, fish, meat, vegetables, etc) are bought and sold Every big town has many such markets In the market of ordinary speech, we have generally the physical presence of the buyer and also of the seller, but this physical presence is not at all necessary in the economic market

The economic market may be not only local, it may be national, or even international—physical presence (*of buyers and sellers*) *is not wanted but only competition between buyers and sellers for the purchase and sale of a commodity* The market of economics refers not to any particular public market-place or market buildings but it refers to buyers and sellers of a commodity extending over a narrow or a wide area as the case may be (the area in some cases would extend to hundreds of miles and more) only if the buyers and sellers are brought into direct competition and business relations with one another The economic market in connection with one commodity (*e g* over-ripe mango) may extend only to one village, the village where it is grown, the economic market for the precious metals gold and silver is world-wide and so on *There are as many economic markets as there are groups of exchangers*

Classes of Markets.

The nature of competition determines the nature of an economic market

So markets are best classified according to the kind of competition operating in them

I *Classification according to areas*, (a) *world markets*; (b) *national markets*, (c) *local markets*

The area of competition determines the area of the market. If the competition is world-wide, if buyers and sellers all over the world are competing for the commodity (*e g* gold or silver), then the commodity has a world market When the competition for a commodity covers the area of a single country, that commodity has a national market The competition for overripe fruit is only local, and so there is only a local market

II *Classification according to time*—(a) *markets for a very short period—one day* , (b) *short-period markets* , (c) *long-period markets*

When we consider the competition conditions (*i e* the demand of the buyers and the supply of the sellers) for a day we have the market for a day , we have the short-period market when we consider the demand and supply for the short period of several months , and the long-period market in connection with the demand and supply in the long period of several years

I. Space limits of a Market—Boundaries of a Market.

Industrial progress is always tending to enlarge the area of the market Railways and steamships, posts and telegraphs are making it possible for the forces of demand and supply (the demand of the buyers for the commodity and the supply of the sellers) to be exercised over large areas and in this way the boundaries of markets for different commodities tend to be more and more widened The improvements in the facilities of communication have made it possible for buyers from all parts of the western world to compete for the same supplies

Conditions for a wide market of a commodity.

Though there is a general tendency in modern times to widen the area of the market, there are many special causes which enlarge or narrow the market of any particular commodity

These causes and conditions have to be considered (A) *on the side of demand* , (B) *on the side of supply* Obviously a commodity has a wide market when the demand for it is wide, and buyers have no difficulty in getting the exact quality (or grade) they want, and the supply is large, not perishable and

of such bulk that it can be carried to long distances to meet the demand of distant buyers

So commodities to have a wide market must have the following characteristics (or many of them) in a large measure—

(1) *Wide demand*—a commodity to have a wide market must be in universal demand

The more wide-spread the demand, other things being equal, the greater will be the area over which its market would extend

Examples of commodities satisfying wants that are universal and urgent, are wheat, cotton, iron, copper, petroleum, etc

(2) *Cognoscibility (capacity for being correctly described by samples, grading, etc)*

This greatly helps buyers and also sellers

A commodity which can be accurately described tends to have a wide market because it can be bought and sold by buyers and sellers at a long distance from one another and at a distance from the stock of the commodity itself simply by a correct description of the thing A commodity can be fully and correctly described if it is suitable for sampling and grading , in such a case samples taken from it will be fully representative of the commodity, and if it is graded into different qualities by a recognized outside authority as in America, its description will be accurate and complete

Grain is very suitable for grading and sampling and so it has a very large market

(3) *Portability and durability.* A commodity is *portable,* it can be carried a long distance economically if it has comparatively large value in proportion to its bulk, *e g* gold, silver, the more expensive wines, etc

Wheat, jute, cotton and copper are portable, though less portable than gold and silver

Bricks of inferior quality have small value in proportion to their bulk and so cannot afford the cost of carriage over a long distance , the result is that the market for these bricks is very narrow *Bricks of superior quality* have greater value in proportion to bulk and so they have a wider market (sometimes a national market) but even these bricks cannot afford the

cost of carriage over very long distances and so the market for them cannot be world-wide *Jeypore marble* has a market all over India , but not inferior stones

Also a commodity to have a wide market must be *durable* and not perishable Gold and silver are durable Fresh fish and vegetables are perishable, they cannot be carried a long distance and they cannot have a wide market , corn and cotton are much more durable, they can be carried to a long distance without deteriorating and therefore they can have a wide market

(4) *Large supply* The supply of a commodity must be comparatively large, if it is to have a wide market

World-wide markets for consols and other international stock-exchange securities and also precious metals.

The greater the degree in which a commodity satisfies these conditions of a wide market the larger its market tends to be Consols* and other well-known stock-exchange securities which have an international reputation and also the precious metals (gold and silver) satisfy in a very high degree these conditions —they are in demand in all countries, they are highly cognoscible (*i e* can be easily and accurately described) and they are extremely portable and durable , and so the market for each of these things is practically world-wide

The world markets for wheat, cotton, jute, iron, copper, etc.

These commodities have also wide markets because they are in general demand all over the world, and they also can be easily and accurately described from a long distance They are somewhat less portable than consols, and the precious metals, they have much less value in proportion to bulk and the markets for these commodities (wheat, cotton, jute, iron, copper) though highly organized are not so highly organized as the markets for the consols, precious metals, etc

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* 'Consols' refer to the Consolidated National Debt of England (corresponding to our কোম্পানীর কাগজ in India)

The restricted markets for district maps, well-fitting clothes, bulky goods, fresh fish and vegetables, etc.

Limited demand, want of cognoscibility, want of portability, want of durability, and limited supply are conditions which restrict the market for a commodity

Things having a *limited demand* (*e g* district maps) have a limited market Again things made to the order of particular individuals to suit their individual peculiarities and tastes (*e g* well-fitting clothes or special furniture made to order to suit special individuals) have narrow markets and in fact only retail markets Commodities which are *bulky*, which have small value in proportion to bulk cannot also have a wide market because of the heavy cost of carriage Fresh milk, fresh fish and vegetables are *perishable* (not durable) and so cannot be carried a long distance and the markets for them are restricted

II. Time Limits of Markets.

Limitations of markets regarding time.

Markets differ as regards *space*, some markets being wider in area than other markets , so they also differ as regards the element of *time* involved Markets differ from one another according to differences in the time allowed to the forces of demand and supply to bring themselves into equilibrium with one another

The economic nature of markets (with value in such markets) varies more with the length of time involved than with variations in the areas covered by the markets

So this element of time requires careful attention and is of great importance , the nature of the equilibrium brought about by the forces of demand and supply and also the causes determining the equilibrium depend greatly upon the period of time allowed to the forces of demand and supply to bring themselves into equilibrium

Prof Marshall classifies markets into four chief classes according to differences in the length of time taken account of

1 When the market extends over only a *very short period*

(say, one day) then the supply of the commodity is limited to the stocks which happen to be at hand

2 When the market extends over *a short period* (say, a few months or a year) the supply of the commodity will be influenced by the cost of producing the commodity in question

3 When the market extends over *a long period* of several years, then the cost of producing the commodity will be again influenced by the cost of producing the labour and the materials needed for producing the commodity

4 The market may also refer to a *very long period* extending from one generation to another and then we have the secular movements of prices

So from the standpoint of time, we have four classes of markets , and corresponding to these we have four classes of equilibrium and four classes of value

Economic progress which has greatly enlarged the space limits of markets, has also extended largely the time limits *Competition now extends over a wider range of time, as also of space* Producers now produce and adjust their supply to meet not only present demands, but also future demands Supply anticipates demand, and sometimes outruns it

Modern highly organized markets.

The markets for consols, and other international securities and the precious metals are very highly organized The price of these things tends to be kept at the same level in all parts of the world—whenever there is a small fall in the price in one country, telegraphic purchases of such a commodity (or a security) by other countries will push up its price in that country , and whenever there is a small rise in its price, the price will be brought down to the level of the price in other countries by telegraphic sales of the commodity (or security) in that country by other countries

The more highly organized the market, the greater will be the tendency which the price has to seek the same level in all parts of the market

A market can be highly organized only (*a*) if there are great transport facilities for moving commodities easily from one place

to another, (*b*) if buyers and sellers are in close contact with one another through post and telegraph so that even a small fluctuation in the price in one part of the market is followed by the movement of forces in other parts of the market tending to keep the price at the same level in all parts of the market Prof Nicholson mentions publicity, freedom of trade and competition, extended area and continuity in time as the characteristics of modern highly organized markets

Interdependence of markets.

Markets and trades are no longer isolated or in distant sympathy with each other With the development of industrial organization, these are becoming more and more interdependent

(Cf Hobson—*The Evolution of Modern Capitalism,* Chapter VI)

CHAPTER III

Markets and Value.

*Importance of the Theory of Value.

An economic market is a group of exchangers (buyers and sellers) Exchanges are carried on in markets, and in the course of these exchanges, the values of commodities (and also services) are determined

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*Prof. Cassel on Economics as a Theory of Price.

He maintains that it is neither necessary nor desirable to have a theory of value preceding a theory of price "It has been a very wide-spread idea that in the exposition of economic theory a separate theory of value ought to go before a theory of price It seems to have been thought that only in this way was a truly thorough-going analysis of economics possible I was brought from the beginning to ask myself earnestly whether it really was necessary that we should go through such a theory of value

First of all, economic science, had, in my view, to be economical in its own methods If a difficult theory of value could be dispensed with, it was a primary duty of economic science to achieve this saving of labour

We now approach the study of value, a most important topic in modern Economics and one which gives a high degree of unity to the science itself *Of modern Economics (according to Marshall and his followers), value is the central theory, though its circumference circles humanity*

In Book II is discussed consumption or the demand side of this central theory of value, and in Book III is discussed production or the supply side *The ideas of Book II and Book III are brought together in Book IV In Book IV, we have the central theory of value*—Demand (Book II) and Supply (Book III) are here brought into relation with each other in markets, the equilibrium of demand and supply is discussed, and it is explained how the value (of a commodity or a service), demand and supply are mutually determined And in Book V on Distribution, this central theory of value is applied to determine the value of the services rendered by Land, Labour, Capital and Organization, or in other words, to determine Rent, Wages, Interest and Profit Value is the central doctrine which gives a pervading sense of unity to the whole subject

Questions of value affect all humanity—a rise (or fall) in the prices of commodities affects more or less all classes of men, how deeply different classes may be affected is quite evident from the effects of the World Economic Depression and falling prices in India and other parts of the world , and

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Further, it was not difficult to see that the theory of value, as mostly exposed in the text-books and in the lecture-rooms, had its serious drawbacks The whole theory suffered from an ambiguity in the conception of "value," of which such phrases as "value in use" and "value in exchange" are familiar examples In fact, value always means a price paid under certain circumstances

As the word 'value' is necessarily somewhat vague and is used, in actual language, in a rather varying sense, the scientific analysis was involved in great difficulties, and much time had to be spent in classifications of value

the essential object of economic science is economic life, and we shall have the best guidance for our way of proceeding if we direct our efforts from the very beginning towards describing this economic life *It will then be quite natural to study the exchange economy in the money form in which it appears in actual life, and it will seem to be a very artificial and round-about way first to build up a separate theory of value without the use of a money unit"*

(Cassel—*Fundamental Thoughts in Economics*)

a rise (or fall) in the values of the services of labour, capital and land bringing about a rise (or fall) in wages, interest and rent affects widely and intimately different classes of the community

(Note that in economically progressive and highly organized countries like modern Britain, or Germany or the U S A, where exchanges and markets are highly developed and practically all commodities and services are exchanged and valued for the purposes of exchange, questions of value are of the highest value and importance to all classes of the people, in India specially in the remote rural parts where exchanges and markets are less developed and much of the local production is for consumption and not for exchange, questions of value are of somewhat less importance, and in very primitive communities, where each family produces all things it requires for its own consumption and there are no markets and exchanges, questions of exchange value do not arise and are not of importance)

Value. Economic Value (Value in Exchange).

A man making a large gift to the poor or the sick is doing a moral act, an act having *moral value*

A Hindu building and dedicating a temple to the god Srikrishna is doing a religious act, an act having *religious value*

Ethics is concerned with moral values, religion is concerned with religious values, and *Economics is primarily concerned with economic values*

Now what is value in Economics?*† *'Value is power in exchange'* The economic value of a thing is its general purchasing power—it is its power to purchase other things in exchange for it Gold has great value in exchange, gold can purchase a great deal in exchange for it, iron or copper has much smaller value in exchange, and air has no value in exchange (though it has great utility as no man can live without air)

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* Recent economists use 'value' to mean 'value in exchange'
Some early economists use 'value' to mean also 'value in use' For the difference between value in use and value in exchange see pages 87-88

† Walker—*Political Economy*, Book I

Value in Economics is a social phenomenon, it depends upon buyers and also sellers Value is the attribute of which wealth is the substance

Value is a social conception.

Value in exchange is a social phenomenon As Prof Seligman puts it "value depends upon the fact not only that each individual measures the relative urgency of his own various wants, but that he compares them consciously or unconsciously with his neighbours I not only measure the relative satisfaction that I can get from apples or nuts, but the quantity of apples I can get for the nuts depends on the relative estimate put upon both by the rest of society"

Can there be a general rise in values and a general rise in prices?

The answers are easy—obvious Other things being equal, if the quantity of money in a country is doubled (or trebled) prices of commodities in general will be doubled (or trebled)—*a general rise in prices is possible,* it has often been brought about in a country by increase in the quantity of money When there is a general rise in prices, it means that gold (money) has fallen in value as compared with commodities—the same amount of a commodity is now worth more money than before

But *a general rise in values is clearly impossible* If wheat rises in value as compared with rice or other commodities, that means other commodities have fallen in value as compared with wheat And so a general rise in values of *all* commodities cannot take place

Negative Value.

Gold, silver, iron, copper, wheat, rice, jute and cotton, all these things have economic value, they have positive value

Things may have also negative value Prof Carver points out that rabbits are so very plentiful in parts of Australia that they are worth less than nothing, they are a regular nuisance and are detested and people would give something to get rid of them and so the rabbits have negative value So weeds in gardens have negative value, and also sometimes the sewage, cinders and the night-soil of houses in large towns

*Jevons holds "The scale of value passes through zero and stretches indefinitely in both directions" The case of zero value is theoretically possible To a man in Calcutta, a tree on the top of the Himalayas has absolutely no utility at all, it has zero value

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* Jevons—*Principles of Economics*

A preliminary sketch of the Theory of Value.

Utility and scarcity (due to cost of production or other causes) in relation to value in exchange.

*Utility and scarcity (due to cost of production or other causes) both *together* govern value in exchange

(1) Utility and Value.

†*Utility is one of the causes of value*—a thing has value only when it has some utility, when it satisfies some human want and is therefore in demand

Utility alone cannot be considered as the source of value in exchange There must be also scarcity (or limitation of supply) For example, air has great utility, we cannot live without air but yet air has no value in exchange because there is an unlimited supply for any one who wants it , when a commodity has utility and so is in demand and at the same time there is a scarcity in supply owing to cost of production or any

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* Prof Seligman states the theory of value in the following manner —"The failure to realise that value is a social conception has led to much pointless controversy Thus Ricardo and his followers maintain that the value of a commodity is fixed by its cost of production, while Jevons and those that agree with him contend that value is fixed by its marginal utility Both are right, but neither is right in the sense in which he understood the terms Cost of production is the measure of value, but it is not, as Ricardo thought, individual cost Marginal utility determines value, but it is not, as Jevons thought, individual utility Both cost and utility measure value, because, as we have seen, marginal social cost is always equal to marginal social utility In the way they frame the statement, the followers of both Ricardo and Jevons are correct in denying the other's statement, and yet err in their own Rightly interpreted, they are correct in their own statement, and yet err in denying the truth of the others" (*Principles of Economics*, Chapter xiii)

† Utility exists in relation to the mind of man, it is something psychical And the fundamental importance of utility in the theory of value brings out the importance of the psychical element in Economic Science In this connection the work of Jevons and of the Austrian psychological school is specially noteworthy

other cause only then the commodity will have value in exchange

The value of a thing depends not on its total utility but on its marginal utility * A man pays a price for a commodity

Clark, Seligman, Marshall on Value in relation to Marginal Utility.

J B Clark also E A Seligman following J B Clark, regard value as determined by social marginal utility Marshall does not accept the idea of social marginal utility This leads to important differences as between Marshall's theory of distribution and Clark's theory

Cassel's criticism of marginal utility theory of value.

"The great importance which has been attributed to this conception of marginal utility was largely artificial, and depended very much on the contrast in which it stood to "total utility," an entirely metaphysical conception without any interest whatever for a simple and straightforward theory of price *When the same school went so far as to declare marginal utility to be the real and ultimate foundation of exchange value, it lost connection both with reality and logic* For, firstly, it is not at all true that marginal utility in every branch of consumption is equal to price For a well-to-do man it is generally larger in a great number of branches of consumption which is proved by the fact that he would buy the same amount of a lot of commodities, even if their prices were considerably higher But secondly, and this is much more important, even when marginal utility and price coincide, marginal utility cannot be represented as the foundation of price, because we never know how much of an article will be consumed, and consequently where the margin lies, before we know the price Thus the claims of the subjective school to have built up a satisfactory theory of value upon their conception of a marginal utility must be rejected, and the importance of this conception must be reduced to the more modest aspiration of throwing a side-light upon connections which are essentially known as soon as economic theory, has decided to represent demand as a function of price"—Gustav Cassel, *Fundamental Thoughts in Economics*, pages 62-63

* Taussig introduces the conception of *marginal vendibility*, when passing from a consideration of the individual's satisfactions to those of a group of individuals "Assume now that a given supply, say 1,000 oranges, is offered by the sellers Among the buyers are some whose means are large, others who value oranges highly But there are more oranges than these purchasers are eager for To induce the rest to buy or to induce the eager purchasers to buy more, the price must be lowered As the sellers are many and competing, the price of the whole supply will be uniform Any one seller, trying to obtain a higher price from the eager buyers, would be undersold by others *There would be one price at which the whole lot would go, and that would be the price which tempted the last buyer, or to be*

which is equal to the marginal utility (*i e* utility of the marginal unit) of the commodity to him—and by the law of the market, all units of the same commodity have the same price in the same market Wheat has got a greater total utility than diamond but it has a smaller marginal utility—and so wheat has got less value than diamond

[For value in relation to consumer's surplus (of utility) see Book II, Chapter I]

(2) Scarcity due to cost of production, etc. and value.

Cost of production or any other cause producing scarcity is one of the causes of value—(if the supply is limited by cost of production of the commodity or any other cause, then only the commodity has value A commodity with an unlimited supply has no value because every one can get enough of it without paying anything

Cost of production (producing scarcity) alone cannot be considered as the source of value in exchange of a commodity There must be also utility

Suppose a man constructs a machine at a cost of 50,000 rupees for producing a commodity which has absolutely no utility—suppose he constructs a machine for blowing soap-bubbles at the rate of 5,000 per minute or with that money he constructs a machine for producing a hideous discordant noise which can be heard twenty miles off Then though the cost of production of the machine is large, yet the machine will have no value because it has no utility

more accurate, the last purchase by any of the buyers This last purchase, and the price which must be offered to induce it, would settle the terms for all the transactions
In the usual statements of the fundamental principle of value, it is stated simply that selling price or exchange value, depends on marginal utility The assumption is here tacitly made that all the buyers are in the same position and that all have the same means
The fact is, however, that purchasers have very different means
The common formulation by economists, that price depends on marginal utility, tacitly ignores the effects of inequality The term "vendibility" points to the dominant position of the price at which the last item is sold "

It is thus seen that utility alone is not the source of value ; and neither cost of production alone can be regarded as the source of value Value is in fact the joint result of (1) *utility and* (2) *of scarcity* (due to cost of production, etc)—if a commodity has utility and so is in demand and if at the same time there is a scarcity in the supply on account of cost of production (or any other cause) then only that commodity has value in exchange

In the words of Prof Marshall ('Utility and cost of production both play a part in governing value') And we might as reasonably dispute whether it is the upper or the under blade of a pair of scissors that cuts a piece of paper as whether value is governed by utility or cost of production "

Marginal cost.

As we have *marginal utility* on the side of demand, so we have *marginal cost* on the side of supply As regards reproducible commodities, the cost that influences value is generally this marginal cost (See pages 387-88)

It is to be carefully noticed that the value of a commodity is determined *at* the margin by the conditions of demand in relation to the supply (the whole supply available)—and *not by* the marginal use of the commodity In other words, 'Margin is a point *at* which and *not by* which value is determined '

As Prof Marshall* puts it, "Marginal uses do not govern

* "Some critics of the modern doctrine of value have misunderstood its character and supposed that it represents the marginal use of a thing as *governing* the value of the whole It is not so, the modern doctrine says we must *go to the margin to study the action of those forces which govern the value of the whole* and this is a very different affair Of course the withdrawal of iron from any of its necessary uses would have just the same influence on its value as its withdrawal from its marginal uses, in the same way as, in the case of a boiler for cooking under high pressure, the pressure in the boiler would be affected by the escape of any other steam just as it would by the escape of the steam in one of the safety-valves But in fact the steam does not escape except through the safety-valves, and iron, or any other agent of production, is not thrown out of use except at points on its marginal uses " (Marshall—*Economics of Industry*, Book VI, Chapter I)

value, but are governed together with value by the conditions of demand in relation to supply "

Particular Classes of Value.

For particular classes of value, see below

For the respective influences of utility and cost of production on the value of reproducible commodities—how the shorter the period, the greater is the influence of utility (demand) on value, and how the longer the period, the greater is the influence of cost of production, refer to pages 373—376

***Mutual causation.**

The utility of a commodity is in its relation to the demand, and the scarcity of a commodity is in its relation to the supply The statement that value is governed by utility and scarcity is also sometimes put in the form that value is governed by demand and supply but the statement is not quite accurate *Value, demand (utility, i e marginal utility) and supply (scarcity)—the relation between these is not one of cause and effect but of mutual causation* Demand (utility) influences value, but value also influences demand,—the lower the price of a thing, the more of it is demanded Supply (scarcity) influences value, but value also influences supply—an increase in the value of a thing tends to increase the supply The demand price, the supply price and the amount produced mutually determine one another

Particular Classes of Value.

Economic values are divided into two broad classes—

(I) Values of commodities

(II) Values of services rendered by Land, Labour, Capital, and Organization

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* Marshall—*Principles*, Appendix I

I. Values of Commodities.

(1) Reproducible Commodities.

As regards commodities, various sorts of conditions relating to supply have to be taken into consideration

For example, some commodities are reproducible and their supplies can be increased, *e g* rice, wheat, sugar, mutton, pianos, bicycles, cigarettes, etc , and some are not reproducible and their supplies cannot be increased

In the case of a reproducible commodity the supply may be limited

(*a*) *by rival producers due to cost of production*

This is the case with most commodities

All producers engaged in the production of the same commodity have not the same cost of production Producers who are more capable or have other advantages have a lower cost of production than others Marginal cost of production is the cost of production of the marginal producer (the man who has the largest cost of production among the producers whose supply is necessary to meet the demand of the market) Generally the marginal cost of production is the cost which has to be taken into account as regards the value of reproducible commodities

(This case of value is discussed in Chapter V)

(*b*) *by a monopoly* and the monopolist's desire to make a maximum profit for himself (This case of value is discussed in Chapter VI)

(2) Non-reproducible Commodities.

Then we have non-reproducible commodities, *e g* land, meteoric iron, also great pictures and statues by old masters,

ancient coins, autographs of distinguished poets, artists and statesmen who are no longer in the land of the living (The values of such commodities are discussed in Chapter IV)

Connected Values.

In Book IV, chapters IV-VII, values (of reproducible and non-reproducible commodities) are studied on the supposition that each commodity has its value determined independently of the value (and demand and supply) of any other commodity

In Book IV, chapter VIII, we study connected values and approach nearer the realities of actual life In real life, the value of a thing is often connected with the values of other things—mutton and wool have their values connected, so also wheat and straw, coke and gas, tea and coffee and many other commodities

International Values.

Then we pass from national values to international values—from the values of commodities within the same nation to the ratios at which commodities exchange between different nations These international values are explained in the chapter on International Trade

II. Values of Services.

In this Book IV we discuss the values of commodities only

The values of the services rendered by Land, Labour, Capital and Organization are studied and explained in Book V on Distribution

The Table set down in the next page gives an idea of the different classes of goods and services, the values of which are determined in Economics

A TABLE.

(2) Non-reproducible goods.

A. Simple Values — *e g* Land, meteoric iron, autographs of great authors, etc

Values of—goods

Reproducible goods. *e g* wheat, rice, pianos bicycles etc

(I) **Monopoly** (*i e* the supply is controlled by a monopoly)
- (*a*) Supply subject to Diminishing Return
- (*b*) Supply subject to Constant Return
- (*c*) Supply subject to Increasing Return

(II) **Competition** (*i e* the supply is produced by competing producers)

Values

B Connected Values (*i e* Values of two or more goods connected either in demand or in supply)
- Goods jointly supplied *e g* rice and straw
- Goods jointly demanded, *e g* bricks and wood in a house
- 3 Goods in composite demand

C. International Values.

Values of Services
1. of Land (i.e. Rent)
2. of Capital (i.e. Interest)
3. of Labour (i.e. Wages)
4. of Organization (i e. Profit)

Reproducible Commodities.

Market Value and Normal Value.

Modern economic writers* split up the study of the value of reproducible commodities into (*a*) the study of market value and (*b*) the study of normal value

Market value of a commodity is generally much influenced by temporary causes, passing events , it is brought about by the *temporary equilibrium of the conditions of demand and supply on any particular day*

Normal value of a commodity is due to more permanent and persistent causes , it is brought about by the normal equilibrium of demand and supply in the short period (short-period normal value) or by the normal equilibrium of demand and supply in the long period (long-period normal value)

The market value of a commodity oscillates about and has a constant tendency to approach a central point (viz the point of normal value) as determined by more permanent causes

Demand and Supply Prices in the Market.

(1) *Definite demand prices in the market*

Suppose the market is a typical economic market with free competition between buyers and sellers

In such a market there is a definite demand price for each amount of a commodity,—that is, there is a definite price for each amount of the commodity at which price that amount of the commodity is demanded in the market and can be sold in that market in a definite unit of time

The law of demand in a market is this—the amount demanded increases with a fall in the price of the commodity and the amount demanded diminishes with a rise in the price of the commodity

For the entire subject of demand—*demand price, the de-*

* See general text-books by Cairnes, Walker, Fisher, Taussig, Marshall and other recent writers

mand of the individual, his demand schedule, the demand of the market, its demand schedule, the general law of demand, etc , refer to Book II, on demand and satisfaction

The Elasticity of Demand.

For this refer to Book II, on Consumption

(2) *Definite supply prices in the market for definite amounts of the commodity*

The supply price of a certain amount of a commodity is the price which is sufficient to call forth that amount of supply of the commodity—it is the sum of the supply prices of the required quantities of factors of production needed to produce the given amount of a commodity

In the typical economic market we have been discussing, there is a definite supply price for each amount of the commodity, a supply price which will call forth a supply of that particular amount in a definite unit of time

Other things being equal, the greater the price offered for that commodity the larger will be the supply and the lower the price offered, the smaller will be the supply ;

The Elasticity of Supply.

An increase in the price offered by purchasers of a commodity increases the supply of it, and if we have regard to short periods only and specially to the transactions of the dealers' market, there is an elasticity of supply corresponding somewhat closely to the elasticity of demand—the elasticity of supply is great if a given rise in price causes a great increase in the amount offered for sale by the sellers, and the elasticity of supply is small if a given increase in price causes a small increase in the amount offered for sale by the sellers

***Equilibrium between Demand and Supply**—*equilibrium price*

When the amount produced in a definite time is such that the demand price is smaller than the supply price, then the

* The notion of equilibrium has been imported into Economics from Mathematics

Forces are conveniently and also profitably studied when in equilibrium, and departures from equilibrium conditions can then be taken up

sellers are getting less than they require to produce that amount of the commodity and bring it to the market, and so the amount of production tends to decrease

When the amount produced in a definite unit of time is such that the demand price is greater than the supply price, then the sellers are getting more than they require for producing that amount of the commodity and marketing it, and so the amount produced will tend to increase

In the above two cases there is no equilibrium of demand and supply

There will be equilibrium of demand and supply and the amount produced will not tend to be increased or decreased *when the demand and supply prices are equal*

The amount in connection with which the demand and supply prices are equal is the *equilibrium amount* and the price is called the *equilibrium price*

There will be equilibria of four different kinds according to differences in time, and there will be four classes of values resulting from these four classes of equilibria

(1) Market Value in the market for a day and resulting from the temporary equilibrium of demand and supply on that day

Here the market on any particular day is considered, and the demand and supply on that day Market value is discussed in Chapter IV

Naturally the simpler types of equilibrium are first studied, and then the more complex cases—in Economics as well as in other sciences

Prof Marshall in his examination of equilibrium in markets refers (a) to the simple type of equilibrium represented by a stone hanging freely from an elastic string and (b) to the more complicated type of equilibrium in the market which may be compared to the case in which the string is supposed to hang in the troubled waters of a mill race, whose stream is at one time allowed to flow freely and at another partially cut off (*Principles*, Book V)

This notion of mechanical equilibrium relating to economic forces is but a preliminary to the study of economic forces in a more complex kind of equilibrium relating to the balancing of forces of growth and decay in connection with an industry or a whole nation, the first kind of equilibrium is mechanical and the second kind biological in nature and conception

(2) Short-period Normal Value in the short-period market and resulting from the equilibrium of demand and supply in the short period

The short-period market is the market extending over a period of several months or say one year , and we consider here demand and supply for the short period

Normal value for the short period is discussed in Chapter V

(3) Long-period Normal Value in the long-period market, and resulting from the equilibrium of demand and supply in the long period

The long-period market is one extending over a period of several years , and here we consider demand and supply extending over this long period

Normal value for the long period is discussed in Chapter V

(The difference between the short and the long period is an approximate one, a hard and fast division cannot be drawn between short and long periods)

(4) Secular changes of Value in very long periods and as brought about by changes in demand and supply extending over a very long period, say from one generation to another

In each of these four classes, value is governed by the relations between demand and supply

And the longer is the period of time taken in consideration, the greater is the influence of cost of production on value This is because the influence of changes in the cost of production takes a longer time to work itself out than the influence of changes in demand

Chapters IV and V *treat of these four classes of value* , and a summary of the conditions of demand and supply and of value in these cases is given at the end of Chapter V

CHAPTER IV

1. Market Price resulting from temporary equilibrium of Demand and Supply.

Here the period allowed to the forces of demand and supply to bring themselves into equilibrium is a very short time, say a day , and the price resulting from this temporary balance of demand and supply is called the market price on that day

(A) Fish—a perishable commodity

Let us see how the period of time (a day) affects the supply The supply of fish on that day in the market is limited to the actual stocks of fish in the market—there is no time to increase or decrease the stock of fish on that particular day in the market to meet an increase or a decrease of demand A temporary equilibrium will be established between the supply and the demand for fish on that particular day , and the price resulting from this temporary equilibrium is the market price of that day

The market price of fish on any particular day will depend upon (a) the actual supply (i e *stocks on that day*) *and (b) the demand for these stocks* The market price, on any particular day, according to a great increase or a great decrease in demand may be much greater or much less than the cost of production of the fish—*in market price, the influence of demand is greater than the influence of cost of production , cost of production and supply have comparatively small influence on market price, for there is no time to increase or decrease the supply*

(B) Rice—a case of a true though temporary equilibrium

Fish is a perishable commodity , but there will be also market price on any particular day for commodities (e g rice, wheat, hats, bicycles, etc etc) which are not so perishable

Take the case of the *market price of rice* on any particular day in a country market for rice Suppose for the sake of simplicity, the rice is all of one grade

The market extending over only a day, there is no time for the supply of the commodity to adjust itself fully to the demand for it—the supply is limited to the *actual stock at hand* on that particular day

	Buyers willing to buy	Sellers willing to sell
Rs 6	per maund 500 maunds	1000 maunds
,, 5	,, ,, 800 ,,	800 ,,
,, 4	,, ,, 900 ,,	600 ,,
,, 3	,, ,, 1200 ,,	400 ,,

The lower the price, the greater is the amount which buyers will be willing to buy and the smaller is the amount which sellers will be willing to sell

Let us suppose on that particular day at Rs 6 per maund buyers are willing to buy 500 maunds but sellers are willing to sell 1000 maunds , at a lower price, at Rs 5 per maund, buyers are willing to buy more, *viz* 800 maunds and sellers, though at the lower price they will not sell 1000 maunds, are willing to sell a smaller amount, *viz* 800 maunds , at a still lower price, *viz* Rs 4 the buyers will be willing to buy an even larger amount, they will now buy 900 maunds but the sellers will be willing to sell a less amount than formerly because of the lower price, and so on

So on that particular day after much bargaining the market price of rice will be very near Rs 5 The price of Rs 5 can be regarded as the *equilibrium price* because at this price the demand (that is, the amount the buyers are willing to buy) and the supply (*i e* the amount the sellers are willing to sell) are equal , and the equilibrium is a *temporary equilibrium* resulting from the conditions of demand and supply as operating on that day

In the market price on any day, demand will have greater influence than the cost of production as there is not the time to adjust the supply fully to the demand by bringing supplies from a distance and by producing further supplies

Fixed and variable supply. Law of Market Price.*

(*a*) In stating the principle of market value, it has been assumed that the supply is a *fixed quantity*, put on the market *This is true as regards a perishable commodity* like fresh fruit or vegetables or fish, etc —the total supply on the day is a fixed quantity and the whole of it must be disposed of at whatever price it will fetch (for the commodity is a perishable one)

(*b*) But with modern scientific progress, measures have been taken in the industrially advanced nations for the preservation of many perishable things Also there are many commodities, jute and cotton, rice and wheat, copper and iron, etc , which are not quickly perishable *As regards such commodities the supply in connection with the market price is not a fixed supply, it is a variable supply*—a higher price in the market on one day leads to the offering of a larger amount by the sellers, and a lower price in the market on another day checks the supply The supply of the commodity offered in the market varies from day to day according to changes in price but the total amount of supply for the season is fixed, it is so much and no more depending on the crop of the season Market price of rice from day to day (the daily equilibrium price) depends upon the daily adjustment of demand and supply in the market , and this market price is influenced by the seasonal equilibrium price which adjusts the seasonal demand to the fixed seasonal supply *Market prices from day to day of a commodity which is not perishable thus fluctuate around the seasonal equilibrium price*

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* "Even market prices are affected by the probable conditions of production and of demand in future and over wide commercial areas" (Nicholson—*Principles*, Vol II)

"It appears to me certain that the supply which determines price is quite as much the supply that is not sold as the supply that is sold, and the demand quite as much the demand that is not satisfied, as the demand satisfied In other words, supply and demand outside the market are among the conditions which determine price within the market" (Cairnes—*Leading Principles*)

Market Prices—Wholesale and Retail.

The retail prices charged by retail shops to consumers do not always quickly follow the changes in wholesale prices brought about by changes in supply and demand

Competition operates with greater force and more quickly as regards wholesale prices than as regards retail prices

Custom exercises more influence upon retail prices than upon wholesale prices When the wholesale price of a commodity has fallen, under the influence of custom, the retail price will remain the same for some time

Retail shops which cater for the richer classes charge higher retail prices to their customers than are charged by retail shops for poorer classes Rich persons will pay the high prices charged by fashionable shops rather than go to the unfashionable shops

Retail prices are proximately influenced by custom It appears as if retail prices are governed by wholesale prices, but the truth is that *retail and also wholesale prices are ultimately governed by marginal demand and marginal utility* In the long run, retail prices are also governed by demand and supply but they do not set a price point so accurately as they do in the case of wholesale price

Fixed retail prices In England, the United States and other industrially advanced countries of the present day, retail prices, charged by the shop-keepers, are very generally *fixed prices*, bargaining about price is not usual Many countries on the continent of Europe and also industrially backward peoples like those of India, China and Persia have not yet adopted in any large measure this system of fixed retail prices

Fixed retail prices avoid friction between the shop-keeper and his customers, save time that would be otherwise wasted in bargaining, and bring about a great increase of efficiency—they are a benefit to the shop-keeper and also to the public at large

Value of non-reproducible, unique and rare things.

Great works of art like pictures by old masters, statues by great sculptors, autographs of Milton or Shakespeare etc , are unique and rare things forming a separate class by themselves ,

no copy can have a value anything like the value of the original The price of such non-reproducible goods has (i) an upper limit fixed by the highest subjective valuation set upon it by any possible buyer and

(ii) a lower limit which will be the seller's own subjective valuation, or the second highest valuation set by any competing buyer, according as the one or the other of these two is higher

The buyers of such things are few, the supply is limited, and the prices are largely indeterminate

The exact price of such a commodity as lying between the upper limit and the lower limit will be determined by pure bargaining The exact price may reach a very high figure if rich persons with a fancy for the thing happen to be in the market as buyers , if not, the thing will be bought by dealers who will sell it later on at a profit, and the *action of these dealers exercises a steadying influence upon the prices of these unique and rare things* .

(The case of the valuation of unique and non-reproducible goods is to be distinguished from the valuation of monopoly goods Monopoly goods are not necessarily unique or non-reproducible , monopoly goods however differ from ordinary reproducible competitive goods in this that monopoly goods cannot be reproduced except by the monopolist)

Utility to sellers

Utility to buyers (marginal utility) has its influence on value Has utility to sellers any effect on the value of a commodity ?

Producers in modern times produce for the market and not for their own consumption The large-scale manufacturer of jute bags or cotton cloth produces for the market, he sells his whole supply—and the utility of a piece of cotton cloth to him for the purpose of consumption does not influence value, the utility to the seller does not affect the value of the commodity

In exceptional cases, utility to sellers may have its effect on value As regards non-reproducible commodities like an ancient statue by a great sculptor, an autograph of a great poet or other things limited in supply, utility to the seller (*e g* his sentimental attachment to the thing) may have its effect on the value of the thing

CHAPTER V

Normal Value—Short period and long period. Real and Money Cost. Marginal Cost.

*Market and Normal Value.

Market value of a commodity is generally much influenced by *temporary causes, passing events* For example, the market value of fish on a day may be greatly increased in a market, if there be a great demand for fish on that particular day, it being a suitable and auspicious occasion for Hindu marriage feasts

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*The term 'Normal' in Economics.

The term Normal is derived from 'norma' (Law)

Normal action in Economics means the course of action which can be expected (from the members of an industrial group, *e g* a group of sellers, a group of labourers or a group of employers, etc), *to result from the given economic conditions Normal action is thus natural action*, the sort of action which is natural under a given set of conditions

Normal does not always mean competitive When the given conditions in a particular case are competitive, *e g*, when there is full and free competition between buyers and sellers, normal action means competitive action, and normal price in this case means competitive price, when the conditions are not those of competition but of a monopoly, normal price means monopoly price (not competitive price)which is expected to result from the given monopoly conditions

Normal action does not always mean moral action When the given conditions are moral, normal action expected to result from these conditions is moral When the conditions are not moral *e g*, a large supply of labourers, ignorant, inefficient, unorganized and so not able to fight with the employers, the normal action of such labourers resulting from such conditions is to accept low wages and highly unsatisfactory conditions of work—and of course this is not moral

In medical science, the normal result of taking prussic acid is death, and in economic science the normal result of a supply of labour under the conditions already described is the degradation of the labourer, neither of these results is moral, but each result is normal in the sense that it would result under the given conditions

So the term Normal is highly elastic Normal always means 'normal' under a particular set of conditions, and normal action under

Normal Value is due to *more permanent and persistent causes* In investigating normal values, we are in search of *general causes* that pervade the industry , and in long periods the various temporary causes and passing events, the fitful and irregular causes, in great measure counteract and neutralise one another's influence Normal value of fish is due to the more permanent conditions of demand and supply

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one set of conditions is quite different from normal action under other sets of conditions We have normal action under moral conditions and normal action under immoral conditions, normal action under competitive conditions, and normal action under monopoly conditions, normal action under short-period conditions, also normal action under long-period conditions—normal price of early potatoes may be 8 annas per seer, and normal price for the whole year may be 8 pice per seer

The idea of Normal Value among economic writers.

Adam Smith and Ricardo have the expression "natural value" and J S Mill calls it "necessary value " They have the idea, but the term normal value is not used by them

J E Cairnes has adopted the term "normal value" from M Cherbuliez's work "Precis de la Science Economique" and he has done a great deal to explain and extend this important conception He shows that normal values are not always cost values, and that true normal values are found in International Trade and also in the case of a Monopoly (Cairnes—*Some Leading Principles of Political Economy*)

Walker seems to take Normal Value in the sense of cost value "A price which corresponds closely to the cost of production may be called Normal Price " (Walker—*Political Economy*, Part III)

Hadley in his *Economics* (Chap III) thus explains Normal Price

"This process of competition tends to force down the price of production in lines where they have been unfairly high, and to maintain or increase them in those where they have been disproportionately low *When this equalizing process has taken place, the price is said to be normal* We may contrast market and normal price by saying that a market price is one at which, for the moment, the supply is equal to the demand, while a normal price is one at which, as long as the existing stage of the arts continues, the production is likely to be equal to the consumption "

Of recent writers, Marshall has made the fullest study of Normal Value, he has split up the study of Normal Value for reproducible commodities into (*a*) Short-period Normal Value and (*b*) Long-period Normal Value and has exhaustively considered the conditions of Demand and Supply (*Principles of Economics, Book V , Elements, Book V*)

A comparison has often been made with the sea, and its tendency to keep its level The sea has its normal level dependent on permanent

Market value is brought about by a temporary equilibrium, it is the result of the equilibrium of the conditions of demand and supply on any particular day, normal value dealing with more permanent and general causes is brought about by a more permanent equilibrium—short-period normal value being due to the equilibrium of demand and supply in the short period of some months and long-period normal value being due to the equilibrium of demand and supply in the long period of several years

(The shorter the period the greater is the influence of demand on value, and the longer the period the greater is the influence of cost of production on value)

Normal value of a commodity is the centre about which its market value oscillates Market value on one day on account of temporary causes (*e g* a temporary increase of demand) may rise higher than normal value, and on another day due to other temporary causes (a temporary decrease of demand) market value may fall below normal value The fluctuations of market value are kept within certain, not perhaps precisely determinable, but still real limits—and market values have a constant tendency to approach a central point (the point of Normal Value) as determined by the more permanent conditions of demand and supply

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causes in the source of supply, the volume of water, depth of the bed and the conformation of the shore, and though the level may be disturbed by passing causes, tides, and storms, the sea has always a tendency to seek its normal level So market values, though they may fluctuate, have a tendency to approach a central point, *viz* the point of normal value

Static (stationary) conditions have to be distinguished from dynamic (changing or progressive) conditions *"Static normal value is like the level of a pond,* we can study it only on the assumption that there is no motion of any kind *Dynamic normal value is like the level of an ocean bay,* where the tide ebbs and flows and the level is slowly changing, *Market value* is like the surface when agitated by the wind" (Seligman—*Principles*) Modern societies are dynamic and progressive, and for them normal value is dynamic

"The essence lies in the tendency of the exchanges of the market to gravitate towards a central point, wherever that tendency is observable, we can predicate of the commodities which exhibit it the possession of a central, usual or normal value" Cairnes—*Leading Principles,* Also Mill—*Principles* (Book III), Taussig—*Principles* (Chapter 12)

What commodities have normal value?

Commodities which are systematically and continuously produced to fill the gaps made by a steady and continuous consumption have normal values, but not all commodities

A commodity, the supply of which is fitful, irregular, not continuous, or highly limited, and the demand for which is unsteady, discontinuous, as buyers are few—such a commodity cannot be said to have a normal value, its value is irregular and largely a matter of chance bargaining

We have normal value due to more permanent conditions of demand and supply as regards (*a*) commodities produced by rival producers, also (*b*) commodities produced by a monopoly Again we have normal values in international trade

Normal Value of Reproducible Commodities.

With regard to the normal value of a reproducible commodity under a particular set of conditions, we have to consider normal demand and also normal supply with reference to that particular set of conditions

For the normal supply we have to consider the cost of production of this normal supply

Real and Money Cost of Production.

(1) Real Cost of Production.

For producing any commodity, we require labour of different kinds and capital in different forms And the *real cost of production* (psychological or subjective cost) of the commodity consists of the *efforts and sacrifices* of men required to produce the commodity—"*the exertions* of all the different kinds of labour that are directly or indirectly involved in making the commodity together with the abstinences or rather the *waitings* required for saving the capital used in making it"

(2) Money Cost of Production.

The money cost of production of a commodity (its expenses of production) consists of the *sums of money* that are to be paid for the efforts and sacrifices forming the real cost of pro-

duction—*the money cost of production is thus the money value of the real cost of production*) The money cost includes all the prices which are to be paid in order to procure the required supply of the efforts and sacrifices that are wanted for producing the commodity and so it is the *supply price* of the commodity

Prof Marshall uses the expression "factors of production" of a commodity to include the labour, machinery, raw materials etc , required for producing the commodity , the expenses of production of a given amount of a commodity (its money cost) include thus the supply prices of the corresponding quantities of the factors of production required to produce the given amount of the commodity, and the total of the supply prices of the factors of production is the supply price of the commodity Trading expenses are part of the supply price (or expenses of production)

The real cost of a commodity is its subjective (or psychological) cost , the money cost is its objective cost The money cost is the cost from the standpoint of the individual employer or business man , the real cost is the cost in terms of efforts and waitings from the social standpoint

Analysis of the Money Cost of Production.

The *supply price* or the *money cost of production* of a definite amount of a commodity (say 100,000 yards of cotton cloth) includes—

1 The *price of raw materials,* (*e g* cotton, coal, and other materials used in making it)

2 The *wear and tear and depreciation* of buildings, machinery and other forms of fixed capital in connection with the production of this amount of the commodity and *also interest and insurance on the capital of the factory*

3 *Wages* of persons working in the factory for the production of this amount of 100,000 yards

4 The gross *earnings of management* of the persons (*a*) undertaking the risks of the business and (*b*) organizing and working it

5 *Trading expenses* (freight to the market, advertising,

and canvassing expenses, etc) in connection with the marketing of this amount of cloth

The supply price of this amount of the commodity will have to be calculated under the assumption that the conditions of supply are normal and the expenses of production are those of a* Representative Firm (a typical firm)

[It is seen that the supply price includes normal profit of the employer, a reasonable remuneration for his time and trouble , but for reasons to be explained later on in the Book on Distribution the supply price of a commodity does not include rent as one of its elements]

Marginal Cost of Production.

Marginal cost of production may be marginal money cost of production or it may refer to marginal real cost of production

The marginal cost (money or real) may mean one or other of the following —

1 It may refer to the *marginal costs* (or expenses) *of a business* consisting in the addition made to the cost of a business by the production of the last increment of the commodity These costs are also called private marginal costs

2 The expression *"marginal costs"* is again used to mean the *complete costs or expenses of the marginal firm per unit of the commodity* produced by the marginal firm

The marginal firm in an industry of a given size is the firm which is just efficient enough to maintain its position when the industry is of that side Some producers have higher costs of production than others There are many men engaged in an industry and their expenses of production per unit of the commodity are different—the most efficient firm producing at the

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* There is considerable elasticity of usage in the use of this word For some writers, the term 'Representative Firm' stands for the marginal or the least efficient firm, for others it refers to the most efficient firm, and for Marshall, the 'Representative Firm' is the typical or normal firm, and not the least or the most efficient

least cost per unit, and the least efficient firm producing at the highest cost each unit of the commodity produced *This least efficient firm is the marginal firm and so the marginal firm has the maximum cost of production* of all firms engaged in the industry, the marginal firm has the highest cost for each unit of the commodity

The supply price of a commodity produced by an industry of a given size tends to equal the cost of production of the marginal firm—it must remunerate the more efficient producers with their lower costs but it must be sufficient also to cover the cost of the marginal firm Otherwise the marginal firm will cease to produce, and so the total supply produced by the different firms will fall short of the total demand

Increasing, Decreasing and Constant Return in relation to Supply Price.

The supply price (cost of production) is subject to the influence of the laws of increasing return, diminishing return and constant return as the case might be

Suppose we construct a list of supply prices (a supply schedule), the supply price of each separate amount of the commodity in a definite unit of time (*e g* a year) being put down against that particular amount of the commodity

If the production of the commodity is subject to the law of increasing return, then if a large amount of commodity is produced the cost per unit will be decreased and so the supply price per unit will diminish

If the production of the commodity is subject to the law of diminishing return, then an increase in the amount of the production will lead to an increase in the cost per unit of the commodity and in other words the supply price per unit will increase

And if the production of the commodity is subject to the law of constant return, then the supply price per unit will remain constant whether the amount of production is increased or decreased or remains constant

Principle of Substitution.

The Principle of Substitution operates in consumption, and it operates also in production

As regards the factors of production, each producer will try to produce his supply of a commodity with the least expense and inconvenience, and so each, according to his business knowledge, ability and resources, will choose factors of production and proportions between these factors which he considers most economical and convenient for his purpose In this way, under the operation of the Principle of Substitution the producers are always experimenting with the factors of production, and they will be constantly attempting to substitute more economical and convenient methods in the place of more expensive and troublesome methods

*Prime and Supplementary Costs. Total Costs.

A business man investing capital in a business under normal conditions expects to recoup himself by the price which he obtains for the various products produced by his business *He expects under normal conditions to sell his products at prices which will cover his prime as well as supplementary costs*

The prime costs and supplementary costs taken together form the *total cost* of the commodity

Prime costs and supplementary costs are distinguished in the following manner

A firm producing a commodity has (a) its general expenses (supplementary costs) and (b) the special costs (prime costs) incurred for supplying a particular order

Suppose a firm gets an order from a railway for manufacturing 50 locomotive engines The *prime costs* (also called special costs) are those which are incurred specially for that particular order and will include (a) the steel, copper and other materials used in making these 50 engines, (b) the wages of that part of labour spent on the 50 engines which is

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* Irving Fisher uses the terms *particular costs and general costs* (*Elementary Principles*, Chapter XVII)

paid by the hour or the piece (and not the salaries of the upper employees), (c) also the extra wear and tear of the plant (*i e* the machinery, due to the making of these 50 engines) Prime costs will not include the general expenses of the factory (as distinguished from the special costs necessitated by making these particular engines)

Supplementary costs will include the general expenses of the business as distinguished from the prime costs These general expenses or permanent charges are (a) on account of the durable plant and building (interest on the capital, charge on account of depreciation, insurance, etc) and (b) also salaries of the upper employees (viz , managers and foremen, etc)

[*Prime costs cease when the business stops even for a short time*—when the factory for a brief period ceases to manufacture, the prime costs relating to raw materials for these engines, also wages of lower grade employees specially employed for a particular order will not be incurred]

Supplementary costs are permanent charges which continue even when the business has stopped manufacturing for a short time When the factory has stopped work for a short period, it will still retain its managers and foremen for good managers and foremen are difficult to get , and the firm will have to pay also the permanent charges in connection with the interest on capital, insurance and depreciation]

The Short Period and the Long Period.

(a) *Short-period price and prime costs* When demand for a commodity falls off during the short period, then the producer will have to sell his commodity at a low price on account of the diminished demand, he will not be able to sell at a price to cover his total cost , but he will generally sell at a price above the prime cost and if the demand is so low that he cannot get a price to recoup him even for his prime cost he would think it better to stop manufacturing for a time Generally even in periods of bad trade he will take a price somewhat above prime costs for fear of 'spoiling the market' So even in the short period, the producer charges a price which covers

the prime costs, and generally a portion at least of the supplementary costs

(b) *Long-period price and total cost*

In the long period, the price of the commodity must be such as to cover the total costs (prime costs and also full supplementary costs) *of the producer,* otherwise the supply of the commodity will not be maintained If there is a collapse of demand in the long period, if the producer is not able to get a price high enough to recoup himself for the total cost in the long period, then he is producing at a loss , and so gradually capital, labour and enterprise will be diverted from that industry to a more productive industry

Normal Values and Normal Prices.

Normal price of a commodity is its normal value, expressed in terms of money

Normal price with reference to a particular period of time (*e g* a short period of a few months or a long period of several years) is the price which tends to be established in that period, under the conditions of demand and supply operating during that period, other conditions remaining unaltered

Of course the greater the length of time with reference to which the term 'normal'* is used, the more fully the economic forces in operation during the period will be able to work themselves out and the more completely they will be able to make their effects immediate and remote and specially the remote effects felt

The term *normal* price is used in different senses with reference to different periods of time and it can be used with reference to very short as well as very long periods

* "The normal or natural value of a commodity is that which economic forces tend to bring about in the *long run* It is the value which economic forces would bring about if the general conditions of life were stationary for a run of time long enough to enable them all to work out their full effect" Marshall

(A) Equilibrium of Normal Demand and Supply during the short period, and the short-period normal price (sub-normal price) resulting from it.

The short period lasts for a few months or a year

As regards *demand*, 'short-period normal demand price' means demand price under the short-period conditions

As regards *supply*, 'short-period normal supply price' is the price at which the supply can be produced under the short-period conditions—in other words, *the supply which can be produced with the existing factors of production (land, labour, capital and organization)*

(Short-period normal price is the price which tends to be established by the equilibrium of normal demand and supply during the short period)

(In the market for one day, the period being very short there is no time to increase or decrease the supply to meet an increased or decreased demand—the supply is therefore the total stock in hand or already in sight In the short-period market, the period being one of several months there is time to produce an increased supply or a decreased supply with the help of the existing factors of production when there is an increased or decreased demand , but there is not time enough to increase or decrease further the supply of the factors of production (land, labour, capital and organization) of the commodity for producing an increased or decreased supply of the commodity so as to adjust the supply even more perfectly to the increased or decreased demand]

For a concrete example of short-period normal value, let us take jute manufacture or the fishing industry

Increase of demand in the short period. *Suppose during the short period there is an increase in the demand for fish,* owing to meat becoming unpopular as food on account of religious or medical considerations

Now this increased demand for fish during this short period will exercise an influence upon the supply of fish during this

short period, the period of increased demand however being a short one, labour, capital and organization will not be attracted from the other industries to the fishing industry to produce the required supply of fish, but an *increase in the supply of fish to meet the increased demand will be brought about as far as possible very largely with the existing amounts of labour, capital and organisation* already engaged in that industry, by making the fishermen and the boats and the nets work for longer hours and also to a certain extent by pressing old and unsuitable boats, nets, etc, in the work of fishing

Normal price with reference to the short period will depend upon the normal supply price relative to that period and that given amount) *The normal supply price relative to the short period is the cost of producing the normal supply for the short period with the existing amounts of skilled labour, capital and organization already engaged in that industry*

Normal supply price of fish *during the short period will be almost always increased by an increase in the amount demanded* —because the increased supply of fish in the short period to meet the increased demand has to be produced with the existing amounts of agents of production at a greater cost of production per unit of the supply The increased supply in the short period has to be produced by working long and uneconomical hours, and also to some extent by using old, antiquated and comparatively inefficient boats, nets, machinery, inefficient labour, etc —hence there is a rise in the cost of production per unit of the increased supply Thus an increase in the amount demanded increases the supply in the market and raises normal supply price in the short period—and this happens as regards commodities subject to diminishing return and also as regards commodities which in the long period are subject to increasing return

Decrease of demand in the short period. (*Suppose there is a diminution in the demand for fish during the short period*

This diminution in the demand for fish will exercise its influence upon the supply of fish during this period The *decreased supply of fish to meet the decreased demand will have to*

be brought about with the existing amounts of agents of production—the period being a short one, the excessive supply of labour, capital and organization in the fishing industry has no time to reduce itself by gradual decay, by transfer to other more profitable industries, and in other ways to the demand for these agents and so the existing agents of production in that industry will not be fully employed

The decrease in demand for that commodity during the short period will lead to a fall in the short-period price and it may lead to a considerable fall, if there is a great deal of fixed capital employed in that industry

Marshall thus sums up as regards the short period

The supply of specialised capital and ability, and of the appropriate industrial organization has not time to be fully adapted to demand, but the producers have to adjust the supply to demand as best as they can with the appliances already at their disposal On the one hand, there is not time materially to increase these appliances if the supply of them is deficient, and on the other, if the supply is excessive, some of them must remain imperfectly employed, since there is not time for the supply to be much reduced by gradual decay and by conversion to other uses The particular income derived from them (these appliances) does not *for the time* affect perceptibly the supply, and does not directly affect the price of the commodities produced by them It (the income derived from these appliances) is a surplus of total receipts over prime costs, but unless it is sufficient to cover in the long run a fair share of the general costs of the business, production will gradually fall off

(B) Equilibrium of normal demand and supply during the long period, and long-period normal price (true normal price) resulting from it

When there is an increased demand for fish during the long period, there is time for the supplies of agents of production to flow from other industries into the fishing industry to meet that increased demand, and when there is a diminished demand for fish during the long period there is also time to reduce gradually the supplies of agents of production (*e g* labour and capital, etc) in the fishing industry by transfer to other industries and partly by not replacing old labourers, worn out material capital, etc

Increase of demand in the long period. *Normal supply price of a commodity in the long period is not always increased by an increase in the amount demanded*—the normal supply price is increased, decreased or remains constant as the commodity is subject in the long period to diminishing return, increasing return or constant return

Decrease of demand in the long period. With a decrease in demand, normal supply price in the long period will fall, rise or remain constant as the commodity is subject to diminishing return, increasing return or constant return

In the long period, therefore, there is a more complete adjustment of the supply of the commodity to the demand for it than in the short period on account of the greater time allowed to the economic forces in operation—in the short period, increase in the supply or diminution in the supply of the commodity is produced with the existing factors of production (*i e* with the existing amounts of specialized skill, specialized capital and specialized organization) and there is no time to enable these producers to increase or diminish the supplies of these factors of production in that industry according to the necessities of the case , while *in the long period of several years there is enough time for producers to bring about a more complete adjustment of the supply of the commodity to the demand for it by increasing or diminishing the supplies of factors of production* (*i e labour, capital and organization*) *to meet increased or decreased demand for the commodity in the long period*

Marshall thus sums up as regards long periods

"In them all investments of capital and efforts in providing the material, plant and the organization of business, and in aquiring trade knowledge and specialized ability have time to be adjusted to the incomes which are expected to be earned by them , and the estimates of these incomes therefore directly govern supply, and are the true long-period normal supply price of the commodities produced Thus that investment of capital in a trade on which the price of the commodity produced by it depends in the long run, is governed by estimates on the one hand of the outgoings required to build up and to work a representative firm, and on the other of the incomings, spread over a long period of time, to be got by such a price "

Different classes of value—a summary.

Four different classes of values can thus be distinguished, and in each value is governed by the relation between demand and supply

1 *Market price on any particular day*

Market prices In this case *supply* means the total stock of the commodity on hand (already available) or in sight

A temporary equilibrium will be established on any market day as regards a commodity between its demand and supply and the price fixed upon may be regarded as the equilibrium price of that day

Dealers (buyers and sellers) in the market in trying to bring about a temporary equilibrium of demand and supply and *in trying to determine the market price for the day look chiefly at present demand* and on the *supply (stocks) of the commodity immediately available*, the dealers in determining market price on any particular day pay comparatively *less attention to the cost of production* of the commodity for there is no time to increase the supply by incurring the cost of production

And specially as regards perishable commodities like fish, fresh vegetables, etc, the *cost of production* has sometimes very little influence upon the market price

2 *Normal prices with reference to a short period (of a few months or a year)*

Normal supply in the short period means the supply which can be produced within the period for a given price with the existing appliances of production

Normal supply price for the short period is the cost of producing the normal supply during the short period with the existing appliances of production

Normal price in the short period is chiefly determined by the *cost of producing the normal supply with the existing*

appliances (labour, capital, organization) during the short period, and the influence of *demand* on short-period normal price is less important

3 *Normal price with reference to a long period* of several years*

Normal supply with reference to a long period means the supply which can be produced within the long period for the price in question with the appliances of production increased or diminished so as to be adjusted to the demand for the commodity produced by these appliances

Long-period normal price of the commodity is *chiefly* determined by this *cost of producing* the normal supply for the long period and this cost in its turn is influenced by the cost of producing the factors of production for the commodity, and the influence of *demand* on long-period normal price is less important

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***Do long-period results actually exist?**

"By the effects of a cause in the long period, one understands what would be the ultimate results, apart from any exceptional conditions (a) if time were given for all the actions and reactions consequent upon the operation of the cause to work themselves out and (b) no other change took place

As in conditions of supply, so in conditions of demand, long-period results are never quite realized

The world's shots at long-period results are like shots at a target which moves constantly but irregularly Before any shot can get home, the target has assumed a new position

Long-period results do not actually exist, their universe is the abstract (Chapman) Long-period results are not actually realised for in actual life they are always being interfered with by changes in other economic conditions—condition (b) is not satisfied, and changes in other conditions are always taking place

Chapman thinks that the discussion of long-period results is still of great use because—

(a) Such a discussion helps to explain what actually is, and this explanation is of practical value The complete explanation of economic phenomena can be found only in a study of tendencies

(b) Though normal positions of equilibrium in the long period are never exactly realized, they are realized approximately in the generality of cases particularly as regards broad economic movements

Many competent economists are of opinion that the idea of normal price has only a metaphysical interest and that changes are not always sufficiently gradual to permit actual prices approximate to normal prices

4 *Secular movements of normal price relative to a very long period*

Secular or very gradual movements of normal price are relative to a very long period, they are caused by gradual growth of knowledge, of population and of capital and of the changing conditions of demand and supply extending from one generation to another

Conclusion.

The shorter the period, the greater is the influence of demand on value, and the longer the period, the greater is the influence of cost of production (as determining the supply)

(*a*) for *market value* on a particular day, demand is more important than cost of production, (*b*) for *value in the short period* lasting several months, cost of production is more important, (*c*) and for *value in the long period* of several years, cost of production again is the more important factor and this cost of production of the commodity in the long period is influenced by the cost of production of the factors of production (labour, capital and organization) required for the commodity *Cost of production influences supply and thus influences value and this takes time—this is the reason why cost has a greater influence on value, the longer is the time taken into consideration*

Values of Wheat and Motor Cars with increased demands in the Long Period.

Wheat is an agricultural commodity and agricultural production is subject to the law of diminishing return

With increased demand for wheat in the long period, the supply will be increased in the long period to meet the increased demand and the long-period equilibrium will be established, and long-period normal value of wheat will be determined by the marginal cost of production The increased supply of wheat in an already thickly populated country being presumably produced under conditions of diminishing return the marginal cost of production will increase So an increased demand for wheat in the long period will bring about a rise in the value of wheat

The result will be just the opposite in the case of motor cars

For motor cars in large and well-equipped modern factories are produced under conditions of increasing return Ordinarily the greater the number of motor cars to be produced by such a factory within a fixed period of time, the less will be the cost of production per car due to increase in economies of machinery, division of labour, marketing, etc With increased demand for motor cars in the long period, the supply of motor cars will be increased in the long period to meet the increased demand , and a long-period equilibrium will be established The increased supply of motor cars in the long period will be produced under conditions of increasing return and the cost of production of the Representative Firm will decrease , and so increased demand for motor cars in the long period, will bring about a decrease in the price of motor cars (not an increase in price as in the case of wheat) due to lowered cost of production

Marshall on the Importance of the Time Element in the Theory of Value

English and American economists generally hold that one of the most important contributions of Marshall to the theory of Economics is his elucidation of the importance of the time element in the theory of value

" 'The explicit introduction of the element of Time as a factor in economic analysis is mainly due to Marshall The conceptions of the "long" and the "short" period are his, and one of his objects was to trace "a continuous thread running through and connecting the applications of the general theory of equilibrium of demand and supply to different periods of time'—*Principles,* Bk VI, Chap XI § 5 'Connected with these there are further distinctions, which we now reckon essential to clear thinking, which are first explicit in Marshall—particularly those between "external" and "internal" economies and between "prime" and "supplementary" cost Of these pairs the first was, I think, a complete novelty when the *Principles* appeared

By means of the distinction between the long and the short period, the meaning of "normal" value was made precise' "—*Alfred Marshall* 1842-1924 by J M Keynes in *Memorials of Alfred Marshall,* 1925, p 43

Marshall's position as regards the importance of the Time element in the theory of value is clearly indicated in the following extracts from his *Principles*

"Markets vary with regard to the period of time which is allowed to the forces of demand and supply to bring themselves into equilibrium with one another, as well as with regard to the area over which they extend And this *element of Time requires more careful attention just now* than does that of Space *For the nature of the equilibrium itself,* and *that of the causes by which it is determined, depend on the length of the period over which the market is taken to extend* We shall find that if the period is short, the supply is limited to the stores which happen to be at hand if the period is longer, the supply will be influenced, more or less, by the cost of producing the commodity in question, and if the period is very long, this cost will in its turn be influenced, more or less, by the cost of producing the labour and the material things required for producing the commodity These three classes of course merge into one another by imperceptible degrees We will begin with the first class, and consider in the next chapter those temporary equilibria of demand and supply, in which the cost of producing the commodity exerts either no influence or merely an indirect influence"—Bk V, Ch I, § 6

"Thus we may conclude that, *as a general rule,* the shorter the period which we are considering, the greater must be the share of our attention which is given to the influence of demand on value, and the longer the period, the more important will be the influence of cost of production on value For *the influence of changes in cost of production takes as a rule a longer time to work itself out than does the influence of changes in demand* The actual value at any time, *the market value* as it is often called, *is often more influenced by passing events and by causes whose action is fitful and short lived,* than by those which are working more persistently all the time But in long periods these fitful and irregular causes in large measure efface one another's influence, so that *in the long run persistent causes dominate value completely* Even the most persistent causes are however liable to change For the whole structure of production is modified, and the relative costs of production of different things are permanently altered, from one generation to another" Bk V Chap III §7

"Four classes stand out In each, price is governed by the relations between demand and supply As regards *market* prices, Supply is taken to mean the stock of the commodity in question which is on hand, or at all events "in sight" As regards *normal* prices, when the term Normal is taken to relate to *short* periods of a few months or a year, Supply means broadly what can be produced for the price in question with the existing stock of plant, personal and impersonal, in the given time As regards *normal* prices, when the term Normal is to refer to *long* periods of several years, Supply means what can be produced by plant, which itself can be remuneratively produced and applied within the given time, while lastly, there are very gradual or *Secular* movements of normal price, caused by the gradual growth of knowledge, of population and of capital, and the changing conditions of

demand and supply from one generation to another"—Bk V, Chap V, § 8

A criticism of Marshall's Long-period Analysis

"No one has explained the shortcomings of static method more carefully than he, and been more aware of the changing character of economic institutions than he appears at times to be Yet, in spite of his belief that social change is biological, not dynamic, in character, his entire theoretical structure, leading up to what is normal in the long run, is dependent upon a halting of all changes in the *kind* of forces at work, and in the proportions, though not the amounts, of population and wealth

He allows, indeed, for change in this sense, that what is to be regarded as normal may shift periodically, one might say daily or momentarily But if, as has been true in the past century, the technique of industry is revolutionized and the relative importance of trades violently altered within each generation, it would appear to be not true that actual prices and income shares oscillate about a normal which represents cost of production In that case, his long-period analysis would appear to be a work of supererogation, though one made no objection to his short-period conclusions"—Paul T Homan, *Contemporary Economic Thought,* 1928, pages 269-270

Marshall's Concept of the Representative Firm in relation to the Theory of Value under conditions of Competitive Equilibrium and Increasing Returns

When an industry is subject to diminishing return and there is competition between different producers in the industry, Marshall has noted there is a long-period equilibrium between demand and supply and the long-period normal value is determined by marginal cost

What happens when the industry is subject to increasing returns?

*It is conceivable that of the different competing firms producing a commodity under conditions of increasing return, one firm as it grows in size continually increases its efficiency and its internal economies, and thus reduces its cost of production and is able to undersell all its rivals till it establishes for itself a monopoly in that industry In that

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* "If internal economies were attained indefinitely as the scale of operations enlarged in each individual establishment, the stage would be eventually reached of complete concentration and complete monopoly If each establishment, or each combination of establishments, found as it grew in size that its efficiency and its economies increased, the successively enlarging enterprises would undersell those rivals who failed to do so, and finally nothing would be left but one giant in sole possession of the field This is the theoretically complete "trust," able to undersell all rivals by virtue of its economies in production "—F W Taussig, *Principles of Economics,* Vol I, 1925, page 191

case the value of the commodity produced by such a firm under such conditions of monopoly will be a monopoly value

But surveying industries in leading countries, it is actually found that in many industries subject to increasing returns, monopoly has not been established and competition prevails *Marshall looks upon the device of the representative firm as a fruitful and indispensable instrument in the construction of the theory of value applicable to an industry with a tendency to increasing returns where competition prevails, and the equilibrium is a competitive equilibrium*

"We cannot regard the conditions of supply by an individual producer as typical of those which govern the general supply in a market We must take account of the fact that very few firms have a long-continued life of active progress, and of the fact that the relations between the individual producer and his special market differ in important respects from those between the whole body of producers and the general market

Thus the history of the individual firm cannot be made into the history of an industry any more than the history of an individual man can be made into the history of mankind And yet the history of mankind is the outcome of the history of individuals, and the aggregate production for a general market is the outcome of the motives which induce individual producers to expand or contract their production *It is just here that our device of a representative firm* comes to our aid* We imagine to ourselves at any time a firm that has its fair share of those internal and external economies, which appertain to the aggregate scale of production in the industry to which it belongs We recognize that the size of such a firm, while partly dependent on changes in technique and in the costs of transport, is governed, other things being equal, by the general expansion of the industry We regard the manager of it as reckoning up whether it would be worth his while to add a certain new line to his undertakings, whether he should introduce a certain new machine and so on We regard him as treating the output which would result from that change more or less as a unit, and weighing in his mind the cost against the gain

The solution of the difficulty is in the action of a representative firm

This then is the marginal cost on which we fix our eyes We do

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* Marshall has described the 'representative firm' in his *Principles of Economics*, p 318 —

"Our representative firm must be one which has had a fairly long life, and fair success, which is managed with normal ability, and which has normal access to the economies, external and internal, which belong to the aggregate volume of production, account being taken of the class of goods produced, the conditions of marketing them and the economic environment generally"

not expect it to fall immediately in consequence of a sudden increase of demand On the contrary we expect the short-period supply price to increase with increasing output But we also expect a gradual increase in demand to increase gradually the size and the efficiency of this representative firm, and to increase the economies both internal and external which are at its disposal

We thus get at the true long period marginal cost, falling with a gradual increase of demand

That is to say, when making lists of supply prices (supply schedules) for long periods in these industries, we set down a diminished supply price against an increased amount of the flow of the goods, meaning thereby that a flow of that increased amount will in the course of time be supplied profitably at that lower price, to meet a fairly steady corresponding demand We exclude from view any economies that may result from substantive new inventions, but we include those which may be expected to arise naturally out of adaptations of existing ideas, and we look towards a position of balance or equilibrium between the forces of progress and decay, which would be attained if the conditions under view were supposed to act uniformly for a long time But such notions must be taken broadly The attempt to make them precise over-reaches our strength If we include in our account nearly all the conditions of real life, the problem is too heavy to be handled, if we select a few, then long-drawn-out and subtle reasonings with regard to them become scientific toys rather than engines for practical work

The theory of stable equilibrium of normal demand and supply helps indeed to give definiteness to our ideas, and in its elementary stages it does not diverge from the actual facts of life, so far as to prevent its giving a fairly trustworthy picture of the chief methods of action of the strongest and most persistent group of economic forces But when pushed to its more remote and intricate logical consequences, it slips away from the conditions of real life In fact we are here verging on the high theme of economic progress, and here therefore it is especially needful to remember that economic problems are imperfectly presented when they are treated as problems of statical equilibrium, and not of organic growth For though the statical treatment alone can give us definiteness and precision of thought, and is therefore a necessary introduction to a more philosophic treatment of society as an organism, it is yet only an introduction

The pure theory in its earlier stages diverges but little from actual facts, but if pushed far its practical value rapidly diminishes

The Statical theory of equilibrium is only an introduction to economic studies, and it is barely even an introduction to the study of the progress and development of industries which show a tendency to increasing return"—Marshall, *Principles of Economics*, Book V, Ch XII, § 2 & 3, pages 459-461

Some recent opinions

Interesting discussions of increasing returns and the representative firm are found in the *Economic Journal*, September, 1928 and March, 1930.

Robbins questions the necessity and usefulness of Marshall's doctrine of the Representative Firm

D H Robertson attempts "a partial rehabilitation of Marshallian orthodoxy"

Piero Sraffa makes destructive criticism of the doctrine and concludes that Marshall's theory should be discarded

I. The problem of value in connection with Constant Return, Diminishing Return and Increasing Return.

The whole supply of the commodity may be produced at a uniform cost by one producer, or the supply may be produced by many different producers each having a different cost of production Theoretically it is also possible, that as regards a particular commodity and under particular conditions, the different producers may be producing, each with the same cost of production

Again the cost of production of the commodity may be subject to the law of constant return or the law of increasing return or the law of decreasing return

(A) *Suppose the commodity is subject to the law of constant return,* suppose the conditions of supply are such that the cost of production per unit of the commodity is the same whether the supply is increased or decreased *Then the value of the commodity will tend to equal the constant expenses of production* (viz, cost of raw material, hire of labour and capital, wear and tear of building, machinery, etc normal profit) and an equilibrium will be established between supply and demand at that level of price and demand will determine the quantity to be produced

(B) *Suppose the commodity is subject to the law of diminishing return,* suppose that increase in supply involves greater expenses of production per unit

If the supply and demand are to be in equilibrium, the equilibrium price of the commodity must be sufficient to remunerate all producers engaged in producing the equilibrium amount (the amount whose marginal utility is measured by the price) The equilibrium price must be sufficient to cover the expenses of each and every unit of the equilibrium supply—*the normal price must be sufficient to cover the expenses of the most expensive unit of the normal supply, (i e, the marginal expenses of production)*, if the price is not sufficient to cover the expenses of production of the most expensive unit of the supply, this supply will not be produced and so the total supply will fall short of the total demand and the equilibrium will be disturbed The total supply falling short of the total demand, the price will be raised till

it will be high enough to cover the expenses of production of the most expensive unit of the normal supply

At the equilibrium, the equilibrium price measures at once the marginal expenses of production of the supply and also the marginal utility of the supply

Marginal use and value.

Some writers have maintained that the marginal use of a thing governs the value of the whole

The truth is that marginal uses do not govern value but are governed together with value by the general relations of demand and supply

(C) *Suppose a commodity is subject to the operation of the law of increasing return, i e*, suppose the increase of supply involves less expenses of production per unit and decrease of supply involves greater expenses of production per unit

In an industry, under the conditions of increasing return, cost of production is to be taken as the cost of production of the representative firm (typical firm) engaged in the industry With increasing returns and rapid industrial improvements and where there is an elastic demand, several points of equilibrium are possible and several equilibrium prices

II Some general remarks.

(1) Demand and supply in relation to value.

To sum up We may bear in mind Marshall's skilful comparison of the working of the two forces of demand and supply to the working of the two blades in a pair of scissors As both blades are wanted for cutting a thing, so *both demand and supply have their influence on value*

When one blade is held still, it may be roughly said that the second blade does the cutting, but the second blade could not cut unless the first blade was also there, so it is clear that *both blades are indispensable, similarly as regards value both demand and supply are indispensable* When demand is fixed, the supply may be roughly said to determine value, but supply does this only because the demand is there and fixed When supply is fixed, the demand may be roughly said to determine value, but again demand does this only because supply is there and is fixed So in each of these cases, *strictly speaking*, both demand and supply have their influence on value, both blades of the scissors are working

(2) Maximum and minimum costs.

Again, suppose the supply of a commodity is produced by different producers and by each producer at a different cost The producer who has the greatest cost (maximum cost or marginal cost) and yet whose supply is necessary is the marginal producer Other producers who are more efficient or who have other advantages have lower costs

(a) When the differences between the different producers are due to *permanent* causes, value is then determined in the long run by cost to the marginal producer—for his supply is also necessary, and therefore the value must be such as to cover his cost and thus to make it worth his while to produce Strictly speaking, such permanent differences are found generally in agriculture, in mining and sometimes also in manufactures One agricultural producer may have land naturally more fertile than the land of another producer, a man may have a mine naturally more productive than that of his competitor, and sometimes even in manufactures, one producer may have a permanent advantage over his rivals in the possession of superior water-power, etc

In all such cases long-run value is determined by marginal cost, the cost of the marginal producer, and the position of the margin would depend on the general conditions of demand and supply

(*b*) In many cases, the differences between the producers are not due to permanent causes In a dynamic and progressive society, the more efficient or better-situated producers will gradually supplant their less fortunate rivals, and under such conditions "it is cost of production at the hands of the more capable and better-equipped producers, not cost of production at the hands of the marginal producer that settles the long-run price as distinguished from the market price" (Taussig, *Principles*, Vol I)

Seligman also may be quoted "While the cost of production on which seasonal or short-time normal supply price depends is greatest or maximum cost, the cost of production which determines permanent normal value is lowest or minimum cost *Hence while normal value is at any given moment at the point of maximum cost, it is under conditions of progress continually moving in the direction of minimum cost*" (*Principles*, Part III)

Normal Price is not always cost price

As regards a reproducible commodity, Normal Price is the cost of production when the supply is produced under conditions of competition by rival producers Normal Price is however, not the cost of production price in the case of a monopoly or in the case of international values

Normal Price is not always competitive

Normal Price is competitive price only when the conditions of demand and supply for a commodity are fully competitive

As a matter of fact, "Market Prices and Normal Prices are alike brought about by a multitude of influences some of which rest on a moral basis, and some on a physical, *of which some are competitive and some are not* "*

Again there is a Normal Monopoly Price for monopoly (as opposed to competitive) conditions

Normal price is not necessarily an average price

Normal price of a commodity for a period (a short period or a long period) is not necessarily the average of the market prices of the commodity on the different days during that period It may be higher than the average price, and it may be lower

Normal price is the price which a given set of conditions *tends* to produce, and it is only by accident and rarely that this Normal Price will be the same as an average price

(In a stationary state, however, Normal Price is always the same thing as the average price)

Normal Price and actual price

Does the Normal Price correspond to an actual price?

An actual price of a commodity is a price actually realized in a particular *sale transaction* between purchasers and sellers in a market, but *Normal Price is the price which tends to be established* under given conditions of demand and supply Every actual price is for a particular transaction, but the *Normal Price is the central point about which all the actual prices in all the transactions oscillate*

And it has been already seen that the Normal Price is not even an average of the actual prices

Normal price is a centre, but a moveable centre

Normal value for a particular period is with reference to the conditions of demand and supply in that period *As the conditions change, normal value also changes*—and with new conditions of demand and supply there is a new normal value The conditions of demand may change through changes in fashions, or the use of substitutes, and the conditions of supply

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* Marshall—*Principles*

may change with new inventions, improvements in methods of production and other things

Normal price is not a single price

We may have two or more normal prices for the same commodity There is the short-period normal price, and there is the long-period normal price The normal price for one set of conditions is different from the normal price for a different set of conditions

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CHAPTER VI

MONOPOLY PRICES.

Questions relating to monopoly, what monopoly means, the different classes of monopolies, etc , have been already discussed in Book III

Here in this chapter we shall discuss *the problem of monopoly price*,* the price which the monopolist will charge for the monopolized commodity

The law of monopoly price.

Now how is this monopoly price determined?

The businessman in his economic life is chiefly guided by the principle of greatest gain The principle applies both to competition and monopoly, but its application is different in the two cases

Now as regards freely reproducible commodities, *under competition* the price of the commodity is limited to the cost of production—competition among rival producers will make the normal price stand at the level of the cost of production of the commodity

The situation will be different under a monopoly

[* First we take up the problem of monopoly price, (a) when the monopoly is complete, (b) later on, cases are considered in which the monopoly is not complete and is limited by various kinds of restrictions on the monopolist's power For some of these cases see pages 411-412]

(The conditions of demand are of course beyond the control of the monopolist But he controls the supply)

Under a complete monopoly, the monopolist-producer monopolizing the supply may fix the price of the commodity higher than cost of production, much higher than cost of production if he thinks it to be in his own interest *Now what is the monopolist's interest? Surely it is to secure for himself the largest possible net revenue* * (Net revenue or net profit = total gross income from the sale of the monopolized commodity *minus* the total expenses of production of the commodity)

So the general law of monopoly price is this (The monopolist with his control over supply will adjust his supply to demand, and he will select that price as the monopoly price which will yield him the largest net profit out of his monopoly) and it all depends upon circumstances whether he gets his largest possible net profit with a low price and a large output, or a high price and small output

When is the monopoly price a high price and when is it a low price?

Other things being equal, the higher the price the smaller will be the demand for the commodity and the smaller will be its sale, and the smaller the price the larger will be its sale

In certain cases (*e g* where the demand for the commodity comes from rich people able to pay a high price), the monopolist will realize his maximum net revenue by limiting his output and selling a small supply at very high monopoly price per unit—here though the total sale is small, the profit per unit is very large on account of the high price, and so the total profits are the maximum net profit possible from the monopoly

In most other cases the monopolist will realize his maximum net profit from his monopoly with a large output, selling

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(* *This will happen if the monopolist is influenced only by the immediate desire for gain*, but he may be influenced in certain cases partly by other motives and then the price charged by him may be lower than the price yielding the maximum net revenue—see page 417)

a large quantity at a moderate price per unit—here the profit per unit is moderate because the price is moderate, but the total profit is large on account of the large sales

It has been pointed out already that demand is beyond the control of the monopolist *He controls the supply, but when his supply is put in the market, the price depends on demand*

So the elasticity of demand is of paramount importance Also a great deal depends upon the fact whether the commodity is produced under conditions of increasing, decreasing or constant costs With inelastic demand and increasing cost (diminishing returns), the output of a monopolised commodity is small and the monopoly price is high, and with elastic demand and decreasing cost (increasing returns) the monopolist finds his largest net profit in an enlarged supply and a low monopoly price

Monopoly price is influenced by cost of production, but in a different way from competitive price (C. U. 1929).

When rival producers under conditions of competition are producing a commodity for the market, long-period normal price is determined by cost of production If a producer attempts to sell at a price higher than the cost of production, he will be undersold by competing producers, who will compel him to lower the price to cost of production (Under conditions of competition, the cost of production includes normal profit, normal remuneration for the employer in that industry)

Competitive price is influenced and governed by the cost of production of the commodity

Monopoly price is also influenced by cost of production, but in a somewhat different way

The monopolist will not sell the commodity produced under monopoly conditions at a price lower than its cost of production By selling at a price lower than cost of production he will have losses In this sense monopoly price is influenced by cost of production

But the monopolist having no rival producers to compel him to lower the price to cost of production often sells at a price higher than the cost of production So the very existence of monopoly conditions makes monopoly price influenced by cost of production in a different way from competitive price The monopolist producing generally on a larger scale than competitive producers, he will generally have a lower cost of production per unit of the commodity in an industry subject to increasing return

With inelastic demand and increasing cost (diminishing return) monopoly price is high and may be much higher than the cost of production, and with elastic demand and decreasing cost (increasing return) monopoly price is low and may be only slightly above the cost of production

Prof. Ely on Monopoly Price.

Prof Ely's remarks on the question of the determination of the monopoly price by the monopolist are of interest in this connection

In determining what price shall be fixed and what quantity shall be supplied—in other words, what is the point of highest net returns, —the monopolist consciously or unconsciously proceeds according to the following principles

1 He realises, that other things being equal, every increase of his monopolised product will result in lowering its price, while every decrease in the supply will result in a higher price

2 Of the expenses of production there are some that in a well-organised business vary roughly in proportion to variation in the supply It will frequently happen that if the product is doubled, cost of raw material and certain other expenses are doubled Such expenses may be called *variable expenses*

3 Other expenses, within the limits of maximum efficiency, remain more clearly the same, no matter what may be the amount of the product These (called the *fixed* or *constant expenses*) include the cost of plant, salary of superintendent, interest on bonds, etc

It follows from the above principles, that the monopolist in a case of this kind, since he is seeking the maximum net revenue from his business, will pay little attention to fixed charges in establishing the price of the product but will consider chiefly the variable expenses in connection with the probable demand for his goods at various points

Limitations upon the powers of the monopolist.

It has been seen that in certain cases, a monopolist will get his largest possible net profit with a high price and a small output, and in certain other cases he will get the largest possible net profit with a low price and a large amount of production

The monopolist will however attempt to get his maximum net revenue with a high price only if his monopoly power over supply is complete and absolute

Complete and unqualified monopoly is rare

In most cases, the monopolist knows that there are limita-

tions upon his power to fix a very high price , if he fixes a very high price for his commodity, (a) *substitutes* for that commodity may be found by the consumers, (b) other men may be stimulated by the excessive profit of the monopolist to *compete* with the monopolist if competition is possible, (c) and finally *restrictions may be imposed by the state* upon the monopolist in the interests of the people

In cases where there are these limitations upon the powers of the monopolist, a prudent monopolist will try to get his monopoly profit with a low price and a large output—and sometimes he may even sacrifice a part of his monopoly revenue to increase consumer's surplus (See page 417)

(*In theory* the monopoly price is fixed at the point of maximum net profit for the monopolist , *in actual life,* the monopolist in practice fixes the price often by rule of thumb and not by strict theoretical analysis)

An interesting law relating to monopoly price.

The greater the intensity of customary use of the monopolized commodity or service, the higher the economic prosperity of the average citizen, and the more readily wealth is spent in a country the higher will be the monoply price charged in the country

The average wealth and the willingness to spend wealth are smaller in France than in the United States , and the result is that monopoly is more profitable and a higher monopoly price can be charged in the United States than in France The average wealth and the willingness to spend are much smaller in India than in France or Britain—and the monopoly price that can be charged in India is generally lower than what can be charged in France or Britain

Monopoly thus shares in the increasing wealth of a country, and it appropriates a large part of it

Two kinds of monopoly prices.

We now proceed to examine two different classes of monopoly prices

1 Monopoly price when one uniform price is charged by the monopolist to all persons

2 Monopoly price when different prices are charged by the monopolist to different classes of persons

I *Determination of monopoly price when the monopolist charges one uniform price to all consumers,* and makes no price discriminations

Take the case of a Tramway Company having the monopoly of tramway traffic in a particular town Suppose the monopolist charges one uniform price to all passengers , and does not divide the passengers into different classes charging different rates for different classes

Suppose the monopolist company finds by calculations, that with a fare rate of 2 pice for each passenger, with a fare rate of 1 anna for each passenger, with a fare rate of 2 annas, etc , —the number of passengers carried, the cost per each passenger, the profit per each passenger and the total net revenue are as set down in the following table

The smaller the fare per passenger, the larger will be the number of passengers carried , and on account of increasing returns in tramway transport, the cost of carrying a passenger will decrease with the increase in the number of passengers carried

Fare	Number of passengers	Cost per head *pice*	Profit per head *pice*	Total net revenue
2 pice	20,000	1½	½	20,000 × ½ pice = 2,500 as
1 anna	10,000	2	2	10,000 × 2 pice = 5,000 as
2 annas	3,200	3	5	3,200 × 5 pice = 4,000 as
3 annas	1,600	4	8	1,600 × 8 pice = 3,200 as

(1 anna = 4 pice)

The monopolist company finds that the total net profit is largest (it amounts to 5000 annas) with a fare rate of 1 anna for each passenger , and *so its monopoly price as regards the fare rate for each passenger will be 1 anna*

II *Determination of monopoly price when the monopolist*

does not charge one uniform price to all consumers, but makes price discrimination

The general principle is the same as in the previous case —the monopolist will select that price as the monopoly price which will yield him the largest possible net profit , but as in this case the monopolist makes price discriminations for different classes, the largest possible net revenue will be different from (in fact it will be bigger than) the largest possible net revenue in the previous case where price discriminations were not made

Now what are the usual kinds of price discriminations made by the monopolist ?

Personal discrimination (*i e* fixing a different price for each different consumer) is not possible under modern conditions of business , and besides it will not be tolerated by the public opinion of any modern society

The usual forms of price discrimination by the monopolist at present are

(i) Class prices.

(—Price discriminations according to differences in incomes or the *system of class prices* An example of class price is charging different rates for the different classes of passengers in a railway or in a ship

How are monopoly class prices determined ?

The monopolist will try to sell to each class at such a price as will make his net profits from that class the largest possible and the result will be that his total net revenue from all classes by charging different rates to different classes will be clearly larger than the total net revenue realised when one uniform price is charged to all consumers Take the illustration on page 413

Instead of charging 10,000 passengers 1 anna each, he will charge 7,000 poor passengers out of the 10,000 1 anna each and will charge 2,000 comparatively well-off persons 2 as each and the remaining 1,000 consisting of rich persons 3 as each ,

and in this way his total net revenue will be larger than 5,000 annas, it will be 9,000 annas

(ii) Use prices.

The monopolist will often charge different prices for the different *uses* of the same commodity, so as to make his net revenue from each of these uses the largest possible A monopolist may supply electric energy at one price for lighting purposes, and at another price when it is used for driving machinery, and at a third price when it is used for cooking purposes

(iii) Price discriminations according to **localities, i.e.,** selling the same commodity at different localities at different prices

This price discrimination may be done by the monopolist among different localities in the same country , and it may be done by him also as between his home country and foreign countries

(When a complete or partial monopolist sells his goods in a foreign country at a lower price than in his own country he is said to be **dumping** ; and in dumping the monopolist sometimes charges in the foreign country a price less than his cost of production per unit of the commodity (cost of production including normal profits))

We may have

(i) Dumping to capture foreign markets

The monopolist may sell his goods in the foreign market below cost of production with the object of driving away competitors out of the foreign market, and after driving out competitors, the monopolist will raise the price in the foreign market and make large profits

(ii) Dumping of surpluses

Sometimes surpluses arise from imperfect adjustment of the monopolist's output to demand These surpluses if sold in the home market will depress prices and so they are dumped in foreign markets

Are monopoly prices in practice usually high prices?

Now in actual practice what do we generally find? Do we find that monopoly prices are generally high prices?

Or do we find that monopoly prices are generally low prices?

Monopolists **answer that monopoly prices are generally low prices, because a monopoly secures many economies from large-scale production, and avoids the wastes incidental to competition**

* Prof Ely in common with most economists holds that monopoly prices are generally high prices, and he supports his view (i) by references to the opinions of historians (ii) and as regards the United States monopoly prices by referring to the judgment of law courts and of other well-informed and qualified investigators as to monopoly prices being high prices

We may conclude thus—

In the United States, there is a high general average of economic well-being, and wealth is very readily spent and so the monopolist there generally makes the monopoly price high in the sense that it is often considerably higher than the cost of production, in countries like Germany and France which are not so rich, the monopoly price will be lower than in the United States, India is much poorer than France and Germany and in India the monopoly price will be generally lower than in France and Germany

Generally speaking, monopoly prices will be higher in rich countries than in poorer ones, and also monopoly prices will be higher the greater is the absence of limitations experienced by the monopolist

Monopoly prices in general are higher than under competition for competitive prices are cost (marginal cost) prices, and monopoly prices are often above cost In some cases, cost under monopoly is less than under competition through a saving of some of the wastes of competition and in such a case monopoly price conceivably may be even lower than competitive price

Are monopoly prices steadier than competitive prices?

Monopolists claim that monopoly prices are steadier than competitive prices They argue in this manner Different rival producers, each engaged in producing and marketing his own supply, will produce a total supply often in excess of the demand, and sometimes less than the demand—they are not able to adjust properly supply to demand, and so there will be comparatively large fluctuations in price, the monopolist having a monopoly of supply is better able to adjust supply to demand, and so under a monopoly prices are steadier

We must not however lose sight of the fact that the monopolist sometimes will deliberately bring about a great fluctuation in prices,—he will raise prices for profit, and sometimes he will reduce the price greatly and will even reduce it below the cost of production to [illegible] out producers who attempt to compete with him

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